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# Dodd-Frank One Year Later: The Public Company Executive Compensation, Governance and Disclosure Provisions

By David Lynn

One year ago today, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). While the Dodd-Frank Act focuses principally on changes to the financial regulatory system, several corporate governance, compensation and disclosure provisions of the Dodd-Frank Act specifically target public companies of all types. These include:

- a requirement that public companies solicit an advisory vote on executive compensation (the “Say-on-Pay” vote), an advisory vote on the frequency of holding an advisory vote on executive compensation (the “Say-on-Frequency” vote) and, in the event of a merger or other similar extraordinary transaction, a vote on certain golden parachute compensation that is triggered by the transaction (a “Say-on-Golden Parachute”) vote;
- requirements that the U.S. Securities and Exchange Commission (the “SEC”) adopt rules directing the securities exchanges to adopt listing standards with respect to the independence of members of the compensation committee and the use of consultants and other advisers to the compensation committee;
- provisions calling for the SEC to adopt expanded disclosure requirements regarding executive compensation matters, including the relationship of pay to performance, the ratio of the amounts of median employee total compensation to CEO total compensation, and whether any employee or director is permitted to purchase financial instruments designed to hedge the value of equity securities;
- provisions that require the SEC to direct the securities exchanges to adopt listing standards with respect to compensation recovery policies that provide for the recoupment of executive compensation in the event of an accounting restatement;
- provisions impacting the ability of brokers to vote uninstructed “street name” shares in their discretion on matters related to director elections, executive compensation and potentially other matters to be determined by the SEC;
- authorization for the SEC to adopt rules permitting shareholders meeting specified criteria to nominate director candidates that must be included in a company’s proxy statement (so-called “proxy access”); and
- new disclosure requirements regarding conflict minerals, mine safety and payments by companies engaged in resource extraction (referred to collectively as “Specialized Corporate Disclosure”).

The SEC has adopted rules implementing the Say-on-Pay, Say-on-Frequency and Say-on-Golden Parachute requirements. Final rules have also been adopted prohibiting broker discretionary voting on executive compensation matters. The SEC adopted rules implementing proxy access (which had been proposed prior to enactment of the Dodd-Frank Act), although the effectiveness of those rules has been stayed pending the resolution of litigation challenging the validity of the rules.

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The SEC has proposed rules regarding compensation committee independence and the use of compensation consultants and other advisers, but has not yet adopted any final rules. Further, the SEC has proposed rules implementing the Specialized Corporate Disclosure provisions, but has not yet adopted final rules. No rules have been proposed or adopted with respect to the relationship of pay to performance, the ratio of the amounts of median employee total compensation to CEO total compensation, and whether any employee or director is permitted to purchase financial instruments designed to hedge the value of equity securities. Further, no rules have been proposed to direct the securities exchanges to adopt listing standards with respect to compensation recovery policies that provide for the recoupment of executive compensation in the event of an accounting restatement. Final action on these proposed rules and expected rules is planned for later this year.

## ADVISORY VOTES ON EXECUTIVE COMPENSATION

### Dodd-Frank Act Requirements

Beginning with shareholder meetings occurring on or after January 21, 2011, Section 951 of the Dodd-Frank Act required that all public companies (except those companies exempted from the requirement by the SEC) include a resolution in their proxy statements asking shareholders to approve, in a nonbinding vote, the compensation of their executive officers, as disclosed under Item 402 of Regulation S-K. A Say-on-Frequency vote is required in the form of a separate resolution asking stockholders to cast a nonbinding vote on whether the Say-on-Pay vote takes place every one, two, or three years.

Section 951 of the Dodd-Frank Act also provides that if golden parachute compensation has not been approved as part of a Say-on-Pay vote, then a company must solicit shareholder approval of certain golden parachute compensation through a separate nonbinding vote at the meeting where the shareholders are asked to approve a merger or similar extraordinary transaction that would trigger payments under the “golden parachute” provisions. The Dodd-Frank Act also requires that any proxy statement used for soliciting the Say-on-Golden Parachute vote must include “clear and simple” disclosure of the golden parachute arrangements or understandings and the amounts payable.

### The SEC’s Implementing Rules

In order to implement these requirements, the SEC adopted new Exchange Act Rule 14a-21, which governs advisory votes on executive compensation going forward (with the exception of those issuers that have indebtedness outstanding under the TARP program, who must solicit annual Say-on-Pay votes under the Emergency Economic Stabilization Act, as amended (the “EESA”), and Exchange Act Rule 14a-20). The SEC also adopted a number of additional rule, form and schedule changes to accommodate the new Say-on-Pay, Say-on-Frequency and Say-on-Golden Parachute votes.

#### *Say-on-Pay Votes*

New Rule 14a-21(a) provides that if a solicitation is made by an issuer relating to an annual or other meeting of shareholders at which directors will be elected and for which the SEC’s rules require executive compensation disclosure pursuant to Item 402 of Regulation S-K, then the issuer must conduct a Say-on-Pay vote, and a Say-on-Pay vote must occur thereafter no later than the annual or other meeting of shareholders held in the third calendar year after the immediately preceding Say-on-Pay vote. The Say-on-Pay vote relates to the executive compensation disclosure required

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to be included in the proxy statement pursuant to Item 402 of Regulation S-K, which generally includes the Compensation Discussion and Analysis (the "CD&A"), the compensation tables, and the narrative disclosure on executive compensation.

The SEC states in the adopting release for the Say-on-Pay rules that it views Section 951 of the Dodd-Frank Act as requiring a separate shareholder vote on executive compensation only with respect to "an annual meeting of shareholders for which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting." Accordingly, Rules 14a-21(a) and 14a-21(b) (governing the Say-on-Frequency vote, as discussed below) are intended to apply in connection with the election of directors when the related proxy materials must include executive compensation disclosure.

Instruction 1 to Rule 14a-21 provides that the Say-on-Pay vote does not cover director compensation disclosed pursuant to paragraphs (k) and (r) of Item 402 of Regulation S-K, as well as any disclosure pursuant to Item 402(s) of Regulation S-K about the company's compensation policies and practices as they relate to risk management and risk-taking incentives. However, if risk considerations are a material aspect of the company's compensation policies or decisions for named executive officers, then the Instruction indicates that the company must discuss these considerations as part of the CD&A, and such disclosure will then be subject to the Say-on-Pay vote.

Rule 14a-21(a) does not require that issuers use a specific form of resolution. However, the Instruction to Rule 14a-21(a) provides the following nonexclusive example that would satisfy the requirements of the rule: "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." While the SEC has provided this nonexclusive example of a form of resolution, the SEC states in the adopting release that companies "should retain the flexibility to craft the resolution language." Companies often adopted different language in order to present their Say-on-Pay vote in the 2011 proxy season, including presenting the vote in the form of a proposal rather than a resolution. In Exchange Act Rules Compliance and Disclosure Interpretations Question 169.05, the SEC Staff has indicated that it is permissible for the Say-on-Pay vote to omit the words, "pursuant to Item 402 of Regulation S-K," and to replace those words with a plain English equivalent, such as "pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the compensation discussion and analysis, the compensation tables and any related material disclosed in this proxy statement."

### *Say-on-Frequency Votes*

Rule 14a-21(b) provides that if a solicitation is made by a company relating to an annual or other meeting of shareholders at which directors will be elected, and for which the SEC's rules require executive compensation disclosure pursuant to Item 402 of Regulation S-K, then that issuer must conduct a Say-on-Frequency vote for its first annual or other meeting of shareholders occurring on or after January 21, 2011, and that such Say-on-Frequency vote must occur thereafter no later than the annual or other meeting of shareholders held in the sixth calendar year after the immediately preceding Say-on-Frequency vote.

Under Rule 14a-21(b), the required Say-on-Frequency resolution must ask shareholders to indicate whether future Say-on-Pay votes should occur every one, two or three years. As a result, shareholders are given four choices on the proxy card: whether the Say-on-Pay vote will take place every one, two, or three years, or to abstain from voting on the

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resolution. In order to implement the voting choices for the Say-on-Frequency vote, the SEC amended Exchange Act Rule 14a-4 to specifically allow proxy cards to reflect the choices of one, two, or three years, or abstain. Rule 14a-21(b) does not require that issuers use a specific form of resolution. Unlike the Say-on-Pay vote requirement in Rule 14a-21(a), the SEC does not provide a nonexclusive example of a Say-on-Frequency resolution. Exchange Act Rules Compliance and Disclosure Interpretations Question 169.04 states, however, that the Say-on-Frequency vote need not be set forth as a resolution. Separately, the Staff has informally cautioned that the Say-on-Frequency vote must be clearly stated, and that in this regard it must be clear that shareholders can vote on the options of every one, two or three years (or abstain from voting), rather than solely following management's recommendation (if any is provided). The SEC Staff also indicates in Exchange Act Rules Compliance and Disclosure Interpretations Question 169.06 that it is permissible for the Say-on-Frequency vote to include the words "every year, every other year, or every three years, or abstain" in lieu of "every 1, 2, or 3 years, or abstain."

Neither Rule 14a-21(b) nor the SEC's other proxy rules require that an issuer make a recommendation with respect to the Say-on-Frequency vote; however, the SEC notes that proxy holders may vote uninstructed proxy cards in accordance with management's recommendation only if the company follows the existing requirements of Rule 14a-4, which include specifying how proxies will be voted (e.g., in accordance with management's recommendations) in the absence of instruction from the shareholder.

## *Exemption for Smaller Reporting Companies*

Companies that qualify as "smaller reporting companies," as that term is defined in SEC rules, as of January 21, 2011 or as a result of being new public thereafter, are not subject to the Say-on-Pay or Say-on-Frequency requirements and the SEC's related rules until 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 under Exchange Act Section 14A and the SEC's rules.

## **ADDITIONAL REQUIREMENTS**

The SEC adopted other changes to rules and forms relating to Say-on-Pay and Say-on-Frequency. The SEC amended Exchange Act 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 contemplates an advisory vote on executive compensation that is not required by Section 14A of the Exchange Act. The SEC adopted Item 24 to Schedule 14A, which requires disclosure, in the proxy statement in which the company is providing a Say-on-Pay, Say-on-Frequency or Say-on-Golden Parachute vote, that the company is providing such vote as required pursuant to Section 14A of the Exchange Act. Further, the company must explain the general effect of such vote, such as that the vote is nonbinding. Companies also must disclose, when applicable, the current frequency of Say-on-Pay votes and when the next Say-on-Pay vote will occur.

The SEC amended Item 402(b)(1) of Regulation S-K to require that a company must address in its CD&A whether and, if so, how the company has considered the results of the most recent shareholder advisory vote on executive compensation (as required by Section 14A of the Exchange Act or Exchange Act Rule 14a-20, which is the rule governing Say-on-Pay

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votes required for recipients of financial assistance under TARP) in determining compensation policies and decisions and, if so, how that consideration has affected the company's compensation decisions and policies. This requirement is included among the mandatory CD&A disclosure items specified by Item 402(b)(1) of Regulation S-K.

Item 5.07 of Form 8-K, as amended, 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, either in the Form 8-K reporting the preliminary or final results, or in an amendment to the Item 5.07 Form 8-K filing (or filings) that disclose the preliminary and final results of the

Say-on-Frequency vote (see Exchange Act Form 8-K Compliance and Disclosure Interpretations Question 121A.04). The Form 8-K amendment is 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. A company must disclose in Item 5.07 of Form 8-K the number of votes cast for each of the choices of every one, two or three years, as well as the number of abstentions.

The SEC added a new Note to Exchange Act Rule 14a-8(i)(10) in order to permit the exclusion of a shareholder proposal as "substantially implemented" if the proposal would provide for a Say-on-Pay vote, seek future Say-on-Pay votes, or relate to the frequency of Say-on-Pay votes. Such shareholder proposals may be excluded under this new Note if, in the most recent Say-on-Frequency vote, a single frequency received a majority of the votes cast and the company adopted a policy for the frequency of Say-on-Pay votes that is consistent with that choice. The Staff has noted that this Note will also apply to shareholder proposals seeking votes on matters that are already "subsumed" within the Say-on-Pay or Say-on-Frequency vote, not just a Section 14A-compliant Say-on-Pay/Say-on-Frequency proposal.

### SAY-ON-GOLDEN PARACHUTE VOTE

Rule 14a-21(c) provides that if a solicitation is made by the company for a meeting of shareholders at which the shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the assets of the issuer, then the company must provide a separate shareholder vote to approve any agreements or understandings and compensation disclosed pursuant to Item 402(t) of Regulation S-K. However, if such agreements or understandings have been subject to a shareholder advisory vote under Rule 14a-21(a) (the Say-on-Pay vote), then a separate shareholder vote is not required. Consistent with Exchange Act Section 14A(b), any agreements or understandings between an acquiring company and the named executive officers of the issuer, where the issuer is not the acquiring company, are not required to be subject to the separate shareholder advisory vote. The SEC did not adopt any specific form of the Say-on-Golden Parachute resolution and has clarified the advisory nature of the Say-on-Golden Parachute vote.

New Item 402(t) of Regulation S-K requires disclosure of named executive officers' golden parachute arrangements in a proxy statement for shareholder approval of a merger, sale of a company's assets or similar transactions. This Item 402(t) disclosure is only required in annual meeting proxy statements when an issuer is seeking to rely on the exception from a separate merger proxy shareholder vote by including the proposed Item 402(t) disclosure in the annual meeting proxy statement soliciting a Say-on-Pay vote.

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Golden parachute compensation must be disclosed in a table along with accompanying footnotes and narrative disclosure. This new table is set forth below:

## Golden Parachute Compensation

Name (a)	Cash (\$) (b)	Equity (\$) (c)	Pension/ NQDC (\$) (d)	Perquisites/ Benefits (\$) (e)	Tax Reimbursement (\$) (f)	Other (\$) (g)	Total (\$) (h)
PEO							
PFO							
A							
B							
C							

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 of the assets, including:

- 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;
- tax reimbursements;
- in the “Other” column, any additional compensation that is not included in any other column; and
- separate footnote identification is required for amounts attributable to “single-trigger” and “double trigger” arrangements.

Item 402(t) of Regulation S-K also requires a description of any material conditions or obligations applicable to the receipt of payment, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, their duration, and provisions regarding waiver or breach. Moreover, disclosure of the specific circumstances that would trigger payment, whether the payments would be lump sum, or annual, and their duration, and by whom the payments would be provided, and other material factors regarding each agreement is also required by Item 402(t). Separate disclosure or quantification with respect to compensation disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table (unless such benefits are enhanced in connection with the transaction), previously vested equity awards and compensation from *bona fide* post-transaction employment agreements entered into in connection with the merger or acquisition is not required.

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In Regulation S-K Compliance and Disclosure Interpretations Question 128B.01, the SEC Staff indicates that Instruction 1 to Item 402(t) specifies that Item 402(t) information must be provided for the individuals covered by Items 402(a)(3)(i), (ii) and (iii) of Regulation S-K. Instruction 1 to Item 402(t)(2) applies only to those executive officers who are included in the Summary Compensation Table under Item 402(a)(3)(iii), because they are the three most highly compensated executive officers other than the principal executive officer and the principal financial officer. Given that under Items 402(a)(3)(i) and (ii), the principal executive officer and the principal financial officer are named executive officers, regardless of compensation level, Instruction 1 to Item 402(t)(2) is not instructive as to whether the principal executive officer or principal financial officer is a named executive officer.

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 a third-party bidders' tender offer statement, so long as the subject transaction is not also Rule 13e-3 going private transaction. Companies 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.

### IMPLEMENTING SAY-ON-PAY, SAY-ON-FREQUENCY AND SAY-ON-GOLDEN PARACHUTE IN 2011

The implementation of Say-on-Pay votes was one of the most widely-anticipated corporate governance developments in the United States over the past five years. Advocates for Say-on-Pay in the United States hoped that the advisory votes on executive compensation would serve to encourage greater accountability for executive compensation decisions, as well as more focused compensation disclosure in proxy statements and expanded shareholder engagement.

During the 2011 proxy season, only forty companies failed to achieve majority shareholder support for mandatory Dodd-Frank Say-on-Pay resolutions. The high level of shareholder support for Say-on-Pay resolutions during the 2011 proxy season was similar to the experience in the recent past with respect to those companies who held Say-on-Pay votes on a voluntary basis, or because the company was required to hold a Say-on-Pay vote because it had outstanding indebtedness under the TARP program. In the vast majority of those situations, shareholders have provided strong support for Say-on-Pay proposals, absent some significant concerns with the company's executive compensation programs. Even with the likelihood of shareholder support relatively high for Say-on-Pay resolutions, companies paid very close attention to the message communicated in through their CD&A and other disclosures, while at the same time seeking to engage with key shareholder constituencies.

#### Disclosure for Say-on-Pay

In many ways, the disclosure that is provided in the proxy statement remains the key point of engagement with shareholders on executive compensation issues. The Say-on-Pay vote caused many companies to streamline and clarify their CD&A disclosure to facilitate utilizing the CD&A to explain why shareholders should support the Say-on-Pay vote. In addition, companies have sought to emphasize the overall "pay for performance" message in the CD&A and throughout the executive compensation disclosure in the proxy statement. To this end, many companies began the CD&A with an "Executive Summary" or "Overview" section. The Executive Summary has proven to be an effective way of communicating the key executive compensation information that shareholders need to make an informed decision on the Say-on-Pay votes. An effective Executive Summary should include:

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- a brief description of the company's financial and business results for the last completed fiscal year, focusing in particular on measures of performance that are relevant to determining the compensation for the named executive officers, while complying with any applicable requirements with respect to the use of non-GAAP measures (see Non-GAAP Financial Measures Compliance and Disclosure Interpretations Question 108.01);
- a discussion of how the issuer's results have impacted executive compensation decisions in the last fiscal year;
- a list of important compensation actions during the last completed fiscal year, including the actions with respect to the CEO and the other named executive officers; and
- a discussion of significant compensation policies and practices implemented or revised, as well as any pre-existing governance and compensation-setting procedures, which demonstrate the issuer's "pay for performance" philosophy and commitment to compensation and corporate governance best practices.

Companies have also been utilizing graphic presentations in the Executive Summary and in the rest of the CD&A as a means of effectively highlighting the issuer's business results and relating those results to the compensation decisions.

An overriding theme has been the relationship between pay and performance. As a result, the Executive Summary and the remainder of the CD&A often focused on how the compensation programs have aligned pay and performance, which necessitated fulsome disclosure about the performance target measures used to determine the level of performance, as well as more detailed disclosure concerning the individual achievements of the named executive officers when such performance is an element pursuant to which compensation is determined.

Disclosures in the 2011 proxy season also included more discussion of how the compensation committee considered the relationship between compensation programs and risks arising for the company in the course of making decisions and taking actions with respect to compensation. This area of focus will likely continue to drive more detailed disclosure in proxy statements about the relationship between compensation and risk.

Many companies addressed the adoption or revision of some key compensation policies, including stock ownership and equity holding policies, compensation recovery policies, policies limiting perquisites and other personal benefits and policies with respect to limiting severance and post-retirement benefits.

### **Engagement for Say-on-Pay Votes**

Active engagement with shareholders on executive compensation and corporate governance issues is one of the expected results of a Say-on-Pay vote. Companies have explored a variety of approaches to accomplish effective engagement with shareholders.

#### *Direct Interaction with Shareholders*

Some companies elected to conduct a "roadshow" focused on (or including as a component) executive compensation and corporate governance matters. These roadshows typically took place in advance of the filing of the proxy statement (e.g., 30-60 days before the proxy statement filing) and were conducted in person or via teleconference, typically involving both portfolio managers and voting analysts at institutional investors and senior level management, and in some cases a director, from the company. The roadshows are largely designed to be informational, rather than serving to actively solicit any vote on expected proposals for the annual meeting, which could present solicitation issues under the SEC's proxy rules. Participants in these engagement activities usually address publicly-disclosed corporate governance and executive

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compensation initiatives demonstrating the company's responsiveness to shareholders, pay-for-performance considerations and the issuer's continuing attention to shareholder concerns (if any) on corporate governance and executive compensation issues. Participants typically avoid discussing material non-public information about the issuer's performance or plans for corporate governance and executive compensation program changes.

In the 2011 proxy season, a group of large institutional investors requested that some large companies hold a "fifth analyst call" to focus on executive compensation and corporate governance issues. The fifth analyst call would take place after a company mailed its proxy statement, but before the annual meeting. The institutional investor proposal for a Fifth Analyst Call sought board member involvement in the call, such as the chairman of the board or the lead independent director. Only one company apparently held a fifth analyst call during the 2011 proxy season.

### *The Use of Additional Soliciting Material*

In a number of situations during the proxy season, Say-on-Pay voting led to the filing of additional soliciting material (filed as under the submission type "DEFA14A" on the SEC's EDGAR filing system) by companies during the period of time between the mailing of the proxy statement and the annual meeting. In many of these situations, the additional soliciting material responded to an adverse Say-on-Pay recommendation made by a proxy adviser, either Institutional Shareholder Services ("ISS") or Glass, Lewis & Co. Companies used the additional soliciting material to identify errors or flaws in the analysis underlying the proxy adviser's recommendation, while at the same time providing arguments as to why the Say-on-Pay proposal should be supported. The use of the additional soliciting material, along with active engagement efforts, most often led to a successful Say-on-Pay vote – approximately 12-13% of recommendations made by proxy advisers were against the Say-on-Pay proposal, while less than 2% of companies failed to obtain majority support in the Say-on-Pay vote during the 2011 proxy season.

A significant proportion of the additional soliciting material filed by companies related to a Say-on-Pay vote responded to an adverse Say-on-Pay recommendation driven in whole or in part by a CEO "pay-for-performance disconnect," as determined under an analytical framework developed by ISS. The ISS CEO pay-for-performance policy is applicable to Russell 3000 companies, and generally screens for a company which has total shareholder returns (as determined by adding stock price appreciation and dividends) over the past 1- and 3- fiscal years below the median level of similar returns for the company's industry "peers," as determined by the issuer's 4-digit GICS grouping. If both the 1- and 3-year returns are below the industry median, then ISS looks to the CEO's "Total Direct Compensation" ("TDC"), as determined by ISS by computing the sum of the salary, bonus, non-equity incentive plan compensation, change in pension and above-market non-qualified deferred compensation earnings and all other compensation directly from the Summary Compensation Table, plus the value of equity awards as calculated by Equilar using their own assumptions. If CEO TDC has not significantly decreased in the last year, then ISS does further analysis, looking at, among other things, the alignment between shareholder returns and CEO TDC over the past five years. Companies complained in additional soliciting material about the limitations of the ISS pay-for-performance analysis, in particular that the GICS peer groups did not match with the issuer's actual peers, the Equilar option valuation was significantly different than the company's determination of grant date fair value as reported in the Summary Compensation Table, TSR represents too narrow of a performance measure, the evaluation time horizon (1 and 3 years) was too short, the analytical approach didn't factor in more recent performance or pay changes, and the ISS approach otherwise failed to capture aspects of a company's compensation program that warranted special attention. Some companies specifically pointed out errors in the ISS or Glass Lewis reports, such as how the proxy adviser may have mistakenly interpreted gross-up provisions or performance-

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based equity awards, calling into question the basis for the recommendation and providing shareholders with more accurate information on which to base a voting decision. In some situations, the additional soliciting material provided additional information relevant to supporting a vote for Say-on-Pay, rather than specifically addressing the recommendation of a proxy adviser.

## **Say-on-Frequency Recommendations and Voting**

Most proxy statements filed in the 2011 proxy season with mandatory Say-on-Frequency votes included a recommendation as to the preferred frequency of future Say-on-Pay votes, with the majority of those recommendations favoring Say-on-Pay votes every year. In approximately half of those cases where issuers recommended a once every three years frequency, shareholders supported an annual Say-on-Pay vote, notwithstanding the once every three years recommendation. In the relatively few situations where the board recommended a Say-on-Pay vote once every two years, an annual frequency for Say-on-Pay voting was favored in approximately 65 percent of those cases. In the few circumstances where no recommendation from the board was provided, shareholders mostly supported an annual Say-on-Pay vote.

Proxy advisory firms ISS and Glass Lewis will only recommend voting for an annual Say-on-Pay vote frequency. Some institutional investors that do not follow ISS or Glass Lewis recommendations also adopted policies supporting annual Say-on-Pay votes. However, a few institutional investors adopted policies providing support for Say-on-Pay votes that occur once every three years. Given these circumstances, obtaining the plurality or majority support of shareholders for an “every three years” or an “every two years” Say-on-Pay voting interval became increasingly difficult as the 2011 proxy season unfolded.

## **Say-on-Golden Parachute Compensation**

A company seeking to avoid an advisory vote on golden parachute compensation in connection with a future vote on a merger or similar extraordinary transaction may voluntarily include the Item 402(t) tabular and narrative disclosures in the proxy statement for an annual meeting at which a Say-on-Pay vote will be held under the Dodd-Frank Act and the SEC’s rules. However, if there are changes to the arrangements after the date of the vote or if new arrangements are entered into that were not subject to a prior Say-on-Pay vote, then a separate shareholder advisory vote on the golden parachute compensation is still required. In that case, the Say-on-Golden Parachute vote is required only with respect to the amended golden parachute payment arrangements. Other than changes that result only in a reduction in the amount of golden parachute compensation or that arise because of a change in the stock price, any other change to the golden parachute arrangements after the Say-on-Pay vote will trigger the requirement for a new vote.

During the 2011 proxy season, only a few companies included the golden parachute compensation disclosure in annual meeting proxy statements where no vote was taking place with respect to a merger or similar transaction. It appears likely that companies will avoid such “advance” votes on golden parachute compensation, given concerns about how the required disclosures concerning golden compensation arrangements could impact the Say-on-Pay vote. In addition, companies may be concerned that providing such disclosures may voluntarily signal to the market that the company could be engaged in a significant transaction in the near future.

Companies have generally adhered closely to the requirements of the Golden Parachute Compensation Table in merger proxies, registration statements and other transactional forms filed since the rules became effective. In some cases, the

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new disclosure results in an additional page of disclosure in the applicable form or schedule, while in other cases the table and footnotes extend over several pages because of the complexity of various scenarios and triggering events. In addition, many companies that have filed merger proxies or registration statements that require a shareholder advisory vote on golden parachutes have described the relationship of the golden parachute advisory vote to other votes on the transaction, including approval of the merger or other transaction itself. While companies are required to disclose that the golden parachute vote is nonbinding, many have gone further to disclose whether or not the golden parachute vote is a condition of the transaction and whether the results of the advisory vote on golden parachutes would affect the consummation of the merger. Approval of the golden parachute arrangements is typically not a condition of the transaction, and a lack of approval of the golden parachutes will not affect consummation of the transaction.

Many companies have included disclosure regarding the effect of the golden parachute advisory vote on the status of the golden parachute payments. This type of disclosure typically notes that the golden parachute arrangements are contractual obligations of the company, and that even though the company values the input of shareholders as to whether such arrangements are appropriate, the company would nonetheless be required contractually to make, and would make, such payments even if the arrangements are not approved by the shareholders in the advisory vote.

### COMPENSATION COMMITTEE INDEPENDENCE AND THE USE OF COMPENSATION ADVISERS

Section 952 of the Dodd-Frank Act added Section 10C to the Exchange Act, which requires that the SEC must direct the national securities exchanges and associations to prohibit the listing of any company issuing equity securities, subject to limited exceptions, unless specific conditions are satisfied with respect to the authority of the compensation committee, the independence of the members of the compensation committee, and the consideration of specific factors relating to the independence of compensation advisers (consultants, legal counsel and other advisers) retained by the compensation committee.

#### The SEC's Proposed Rules

The SEC proposed rules on March 30, 2011 to implement these provisions of Section 952 of the Dodd-Frank Act. The SEC sought public comment on the proposed rules through April 29, 2011, and the Dodd-Frank Act specified that the SEC's rules must have been adopted by July 16, 2011. The SEC has not yet adopted any rules regarding compensation committee independence and the use of compensation consultants and other advisers.

The SEC has proposed Rule 10C-1 under the Section 10C of the Exchange Act 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. Following adoption of the final rules by the SEC, the national securities exchanges will propose and adopt listing standards in accordance with the SEC's final rules.

#### *Compensation Committee Independence and Authority*

Under proposed Rule 10C-1, the exchanges would be required specify in their listing standards that each member of a compensation committee must be an independent member of the board of directors. Independence for the purposes of serving on the compensation committee is not specifically defined in the Dodd-Frank Act or the proposed SEC rules, although the definition adopted by the exchanges must consider the following relevant factors: (1) the sources of compensation of the director, including any consulting, advisory or other compensatory fee paid by the company to the director, and (2) whether the director is affiliated with the company or any of its subsidiaries or their affiliates.

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The SEC has proposed to provide the exchanges with more discretion in setting the definition of independence than is currently available with respect to the independence of audit committee members, as required pursuant to the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”). The SEC has not proposed any additional factors to be considered by the exchanges in establishing their listing standards. The exchanges may consider and adopt additional relevant factors to be considered when determining if a compensation committee member is independent. The SEC sought comment on its approach to provide the exchanges with the discretion to determine the appropriate independence standards, and asked whether additional mandatory factors should be included in the SEC’s rules, such as business or personal relationships that compensation committee members have with management or significant shareholders. The SEC also requested comment on whether a “look back” period should be specified with respect to the independence determination.

As directed by the Dodd-Frank Act, the listing standards must also provide that the compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of compensation consultants, independent legal counsel and other advisers (collectively, the “compensation advisers”), and must be directly responsible for appointing, compensating and providing oversight of the work of the compensation adviser. The company must provide appropriate funding (as determined by the compensation committee) for payment of reasonable compensation to compensation advisers.

The SEC specified in the proposing release that the proposed rules would not require that the compensation committee act in accordance with the advice of compensation advisers or otherwise affect the ability or obligation of the compensation committee to exercise its own judgment. Further, the proposed rules and the resulting listing standards are not intended to preclude the engagement of non-independent legal counsel or obtaining advice from in-house or outside counsel retained by the issuer or the issuer’s management. It is expected that, similar to the listing standards adopted following the Sarbanes-Oxley Act, the exchanges would require that the above-referenced authority and funding considerations be addressed in the charter for the compensation committee.

### *Compensation Adviser Independence*

Under the Dodd-Frank Act and the SEC’s implementing rules, compensation committees must consider certain independence criteria prior to hiring compensation advisers, including the following factors: (1) the provision of other services to the company by the firm employing the compensation adviser; (2) the amount of fees received from the company by the firm employing the compensation adviser, as a percentage of that firm’s total revenue; (3) the policies and procedures adopted by the firm employing the compensation adviser that are designed to prevent conflicts of interest; (4) any business or personal relationship of the compensation adviser with a member of the compensation committee; and (5) the compensation adviser’s ownership of the company’s stock. The SEC’s proposed rules do not define or provide further clarification regarding any of these factors, and did not propose and other factors to be considered. The SEC solicited comment on whether any additional factors should be specified in the rule, and whether any particular considerations should be taken into account in determining, consistent with Section 10C, that a factor is competitively neutral.

### *Proposed Exemptions and Applicability of Listing Standards*

In accordance with Section 10C, the listing standards requirements for compensation committee member independence and compensation committee adviser independence would not apply to controlled companies, issuers of securities futures products cleared by a registered clearing agency or a clearing agency exempt from registration, or registered clearing

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agencies that issue standardized options. Section 10C and the SEC's proposed rules also exempt the following categories of companies from the compensation committee member independence requirement: limited partnerships; companies in bankruptcy proceedings; open-end management investment companies registered under the Investment Company Act of 1940; and foreign private issuers that disclose annually why they do not have an independent compensation committee.

While Section 10C provides that the SEC's rules permit an exchange to exempt a particular relationship from the compensation committee independence requirements, the SEC did not propose to exempt any particular relationships at this time. The SEC indicates that it should be up to exchanges to make the determination of whether a particular relationship should be exempted. Section 10C also provides that the SEC's rules must permit the exchanges to exempt any category of issuers, taking into consideration the size of the issuer and other relevant factors that are deemed appropriate, subject to review by the SEC.

The SEC's rules as proposed would provide that the listing standards apply to any committee of the board overseeing a company's executive compensation, whether or not that committee is specifically designated as the compensation committee.

The proposed rules would provide a listed company with a reasonable opportunity to cure any compensation committee member independence issues prior to delisting after the new standards go into effect.

### *Proposed Disclosures Regarding Compensation Consultants*

In accordance with Section 10C, the SEC is proposing to expand its current disclosure requirements regarding compensation consultants. The SEC proposes to amend Item 407 of Regulation S-K to specifically require disclosure of the retention of compensation consultants and conflicts with compensation consultants.

Under the SEC's 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 year, changing the current standard that disclosure is required as to whether compensation consultants played "any role" in the process for determining or recommending the amount or form of any executive or director compensation. For purposes of triggering this disclosure, a compensation committee would be considered to have "obtained the advice" of a compensation consultant if the committee or management has requested or received advice from the consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the consultant and the compensation committee or management or any payment of fees to the consultant for its advice.

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. While the SEC has not proposed to define what would constitute a conflict of interest, the proposed rule would provide that the same five factors for considering consultant independence under Section 10C should be considered in determining whether a conflict of interest exists.

In addition, as is presently the case, to the extent that a compensation consultant that is advising the compensation committee or management on executive or director compensation matters also provides additional services in excess of \$120,000 during the company's last completed fiscal year, then the company would need to disclose the aggregate fees for the executive or director compensation-related services and the aggregate fees for the additional services.

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The proposed expanded disclosures required by Item 407 of Regulation S-K would continue to apply for disclosures in proxy statements and information statements for annual meetings, or special meetings in lieu of an annual meeting, at which directors are elected.

## **Implementation Timetable**

After the SEC has adopted final rules, the exchanges will have 90 days from the publication of those final rules in the Federal Register to propose listing standards contemplated by Exchange Act Section 10C and the SEC's rules. The proposed listing standards will be subject to further public comment, and must be adopted by the SEC no later than one year after the SEC's final rules are published in the Federal Register.

It is expected that the SEC and the exchanges will work together on adopting the final listing standards in the second half of 2011. As with the adoption of corporate governance listing standards following the Sarbanes-Oxley Act, it is expected that the SEC will endeavor to encourage as much uniformity as possible in the listing standards adopted by the various exchanges.

## **EXPANDED COMPENSATION DISCLOSURE**

Several provisions of the Dodd-Frank Act require that the SEC further expand the disclosure requirements applicable for proxy statements and other filings to address several areas of compensation with respect to employees, executive officers, and directors.

### **Disclosure of Pay versus Performance**

Section 953(a) of the Dodd-Frank Act directs the SEC to adopt rules mandating that a company disclose the relationship of the compensation actually paid to their executive officers versus the company's financial performance, taking into account changes in the value of stock and dividends or distributions. This disclosure may be presented graphically or in narrative form. No implementing rules have been proposed by the SEC, however the SEC expects to propose and adopt implementing rules in the second half of 2011.

### **Disclosure of CEO Pay versus Median Employee Pay**

Section 953(b) of the Dodd-Frank Act directs the SEC to adopt rules mandating disclosure of the median annual total compensation of all employees (except the CEO), the annual total compensation of the CEO, and the ratio of the median employee total compensation to the CEO total compensation. Total compensation is determined by reference to the "total compensation" column of the Summary Compensation Table, as in effect immediately prior to enactment of the Dodd-Frank Act. No implementing rules have been proposed by the SEC, however the SEC expects to propose and adopt implementing rules in the second half of 2011. Debate has continued in Congress on the question of whether this provision should be repealed or modified, although no significant legislative action has been taken to date.

### **Disclosure of Employee or Director Hedging Policies**

Section 955 of the Dodd-Frank Act directs the SEC to adopt rules mandating 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. No implementing

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rules have been proposed by the SEC, however the SEC expects to propose and adopt implementing rules in the second half of 2011.

## **ADDITIONAL GOVERNANCE PROVISIONS**

The Dodd-Frank Act also included a number of additional corporate governance-oriented requirements, some of which the SEC had already addressed or was in the process of addressing at the time of enactment of the Dodd-Frank Act.

### **Compensation Recovery**

Section 954 of the Dodd-Frank Act requires that stock exchange listing standards be amended to require that companies adopt a policy providing that, if a company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, it will recover from any current or former executive officer who received incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the date on which the company is required to prepare an accounting restatement, amounts based on the erroneous data, in excess of what would have been paid under the restatement. Additional disclosure will also 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. No implementing rules have been proposed by the SEC, however the SEC expects to propose and adopt implementing rules in the second half of 2011.

### **Separation of Chairman and CEO Positions**

Section 972 of the Dodd-Frank Act directs the SEC to promulgate rules mandating proxy statement disclosure of the reasons why a company has chosen to have one person serve as Chairman and CEO, or to have different individuals serve in those roles. The SEC amended its disclosure rules in December 2009 to require a discussion of this topic, and it appears that no further SEC rulemaking will be completed on this topic.

### **Broker Discretionary Voting**

Section 957 of the Dodd-Frank Act bars brokers from using discretionary authority to vote uninstructed shares held in "street name" in connection with election of directors, executive compensation, or other significant matters, as determined by the SEC. 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**

Section 971 of the Dodd-Frank Act provided the SEC with authority to promulgate "proxy access" rules, allowing specified shareholders to include director nominees in a company's proxy materials. The Dodd-Frank Act did not prescribe specific standards for these rules, and the SEC had in fact proposed proxy access rules prior to enactment of the Dodd-Frank Act. The SEC issued final rules facilitating shareholder director nominations on August 25, 2010, and such rules were scheduled to become effective on November 15, 2010. However, the effectiveness of these rules has been stayed due to litigation challenging the rules.

On September 29, 2010, the Business Roundtable and Chamber of Commerce of the United States of America filed a petition with the United States Court of Appeals for the District of Columbia Circuit seeking judicial review of the changes

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to the SEC's proxy access and related rules, and on the same day filed with the SEC a request to stay the effective date of newly adopted Exchange Act Rule 14a-11 and associated amendments to the SEC's rules. On October 4, 2010, the SEC granted the request for a stay of the rules pending resolution of the petition for review by the court. Briefing and oral arguments in the litigation has been completed, and a decision of the Court is expected in the summer of 2011. The outcome of the lawsuit could result in the need for the SEC to eliminate or modify Rule 14a-11 and related rules, or the Court could potentially uphold the validity of Rule 14a-11 and related rules and those rules would thereafter become effective upon order of the SEC. Even if Rule 14a-11 and related rules do not become effective as a result of the litigation, there exists the potential that in the shareholders could seek to include a proposal in a company's proxy statement pursuant to Exchange Act Rule 14a-8 which would seek to establish a means for stockholder nominees for director to be included in the company's proxy statement under an approach similar to that contemplated by Rule 14a-11.

Under Rule 14a-11 as adopted by the SEC, qualifying shareholders or groups holding at least three percent of the voting power of a company's securities, who have held their shares for at least three years, would have the right to include director nominees in proxy materials upon meeting certain other requirements. An amendment to existing Rule 14a-8 provides that companies may not exclude from their proxy materials shareholder proposals for less restrictive proxy access procedures.

Rule 14a-11 provides for a "universal" proxy access provision. In this regard, all public companies soliciting proxies would be required to include in their proxy materials qualifying nominees to the board of directors of one or more shareholders meeting the specified criteria for ownership. 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. However, Rule 14a-11 would not apply if state or foreign law or a company's governing documents prohibit shareholders from nominating directors. The SEC Staff and SEC Commissioners have expressed the view 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. Under the analysis discussed by the Staff, bylaw provisions that might be considered an impermissible "opt-out" of the requirements of Rule 14a-11 would include: (1) 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); (2) providing for higher thresholds for the percentage ownership and/or the duration of ownership than what is contemplated by Rule 14a-11; and (3) imposing differential director qualifications on Rule 14a-11 nominees relative to other director nominees. However, the Staff has clarified that the rules are not intended to override or supplant a company's advance notice by-laws or other provisions of a company's state law governing documents related to director nominations or qualifications. The SEC Staff has emphasized that any such provisions included in a company's governing documents should be reasonable and should apply equally to all stockholder-nominated directors, not just directors proposed by a stockholder under Exchange Act Rule 14a-11. In this regard, the adoption of changes to the bylaws with respect to the advance notice provisions, provisions relating to director nominations or qualifications and the conduct of the annual meeting can provide a company with an important measure of control of over the nomination of directors by stockholders and the potential election of those directors by the company's shareholders.

If Rule 14a-11 becomes effective as 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

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annual meeting. 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:

- 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;
- 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;
- provide proof of ownership of the voting securities used for the purpose of satisfying the ownership requirement;
- 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; and
- state in the Schedule 14N the intent of the shareholder or shareholders with respect to ownership of the company's securities after the election.

In calculating the three percent voting power threshold, the following rules would apply:

- the nominating shareholder must hold a class of securities subject to the proxy rules (*i.e.*, not privately held classes of voting securities);
- 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);
- shareholders may aggregate holdings in order to meet the threshold, as long as they all meet the length of holding requirement;
- 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; and
- borrowed shares and shares sold short are not counted.

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.

A company would not be required to include a shareholder nominee in its proxy materials under Rule 14a-11 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). A nominee would need to satisfy the *objective* director independence listing standards that apply to the company (if any apply). 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).

Under Rule 14a-11 as adopted, 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 percent of the company's board (rounding down). With a staggered board, the 25 percent is based on the total number of board seats, not just the directors up for election. In the event that a nominating shareholder owns a class of securities that has the right to elect only a portion of the board,

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then the maximum number of nominees is based on the number of directors that the particular 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 percent cap.

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.

The nominating shareholder or group would need to provide the company, and file with the SEC, a Schedule 14N, which must include disclosure of:

- the amount and percentage of voting securities owned by the nominating shareholder or group;
- the length of time of the nominating shareholder's or group's ownership;
- information concerning the nominating shareholder or group and the nominees that is equivalent to what would be provided in a proxy contest;
- the nominating shareholder's or group's intent to continue to hold the securities through the date of the meeting;
- whether or not the nominee satisfies the director qualification requirements, if any, as set forth in the company's governing documents; and
- at the nominating shareholder's option, a statement of support for the nominee.

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.

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 contemplates a process whereby a company can seek no-action relief from the Staff of the SEC if it intends to exclude a nominee or nominees, including specific deadlines for such submissions.

The SEC also amended Rule 14a-8(i)(8) in connection with the proxy access rules. 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. If amended Rule 14a-8(i)(8) becomes 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. The SEC also codified some of the Staff's historical interpretations of 14a-8(i)(8) which permitted exclusion of a shareholder proposal that would:

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(1) seek to disqualify a nominee standing for election; (2) remove a director from office before the expiration of his or her term; (3) question the competence, business judgment or character of a nominee or director; (4) nominate a specific individual for election to the board of directors, other than through the Rule 14a-11 process, an applicable state law provision, or an issuer's governing documents; or (5) otherwise affect the outcome of the upcoming election of directors.

The SEC also made a series of related rule changes in connection with proxy access:

- *Rule 14a-2(b)(7)* – provides for a narrowly tailored exemption for “solicitations” made in connection with formation of a nominating group;
- *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;
- *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;
- *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;
- *Rules 13d-1(b) and (c)* – would provide that nominating shareholders or groups may remain on Schedule 13G, notwithstanding activities undertaken with respect to a nomination under Rule 14a-11;
- *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;
- *Item 5.08 of Form 8-K* – requires 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.

## SPECIALIZED CORPORATE DISCLOSURE

Title XV of the Dodd-Frank Act, entitled “Miscellaneous Provisions,” contains what the SEC has described as the Specialized Corporate Disclosure provisions. Section 1502 of the Dodd-Frank 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. Section 1503 of the Dodd-Frank Act requires any reporting company 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. Companies 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.” Section 1504 of the Dodd-Frank requires reporting companies 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.

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The Dodd-Frank Act established a very aggressive timetable for rulemaking under the Specialized Corporate Disclosure provisions. The regulations required by Sections 1502 and 1504 were required to be adopted no later than 270 days after the Dodd-Frank Act's date of enactment. While no rulemaking was required under Section 1503, the SEC proposed rules at the same time that it proposed the rules required by Sections 1502 and 1504 of the Dodd-Frank Act, and it is expected that the rules under Section 1503 would be adopted at the same time that final rules are adopted under Sections 1502 and 1504. The SEC proposed rules under Section 1502, 1503 and 1504 in December 2010, however these rules have not yet been adopted. The SEC expects to adopt these rules in the second half of 2011.

The Specialized Corporate Disclosure provisions of the Dodd-Frank Act developed out of discrete public policy concerns, rather than concerns that shareholders or potential investors in public companies were being misled about the level of involvement of public companies in the use of conflict minerals, mine safety issues, or the payments to governments made by companies in extractive resource industries. As a result, these Specialized Corporate Disclosure provisions represent a significant shift away from the SEC's mission to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The requirements for Specialized Corporate Disclosure 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. Rather, the requirements are based on a determination through the legislative process that the importance of the underlying public policy warrants the use of the public disclosure regime as a means for more broadly disseminating information that is of interest to certain members of the public, although not necessarily of interest to any investor.

### **Conflict Minerals Disclosure**

Section 1502 of the Dodd-Frank Act seeks to address (at least in part), through disclosure in SEC filings made by those public companies that are subject to the requirements, the highly sensitive political controversy raised by ongoing armed conflict in the Democratic Republic of the Congo (formerly Zaire) and the adjoining region in Africa. 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.

Section 1502 of the Dodd-Frank Act requires specified 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 things, the measures taken to exercise due diligence on the source and chain of custody of those minerals, which must include an independent private sector audit of the report that is certified by the person filing the report. 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 conflict in the Democratic Republic of the Congo or an adjoining country. 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. As the SEC noted in the proposing release for the conflict minerals rules, cassiterite is the metal ore commonly used to produce tin, which is used in alloys, tin plating, and solders for joining pipes and electronic circuits. Columbite-tantalite is the metal ore from which tantalum is extracted; tantalum is used in electronic components, including mobile telephones, computers, videogame consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components. Gold is used for making jewelry, and is also used in a wide range of electronic, communications, and aerospace equipment. Wolframite is used to produce tungsten, which is used for metal wires, electrodes, and contacts in lighting, electronic, electrical, heating, and welding applications. Given the wide range of uses for these conflict minerals,

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the SEC expects that the conflict minerals disclosure requirements will apply to many different companies across a wide array of industries.

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.” Under the SEC’s proposed rules, a company 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. Further, the SEC’s proposed rules would specify that if a company concludes that its conflict minerals did not originate in the Democratic Republic of the Congo countries, then the company 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. In addition, such a company 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 company’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.

By contrast, under the SEC’s proposed rules, if a company concludes that its conflict minerals did originate in the Democratic Republic of the Congo countries, or the company is unable to conclude that its conflict minerals did not originate in the Democratic Republic of the Congo countries, then the company would similarly disclose this conclusion in its annual report. The SEC’s proposed rules also require that a more comprehensive Conflict Minerals Report (discussed below) is furnished as an exhibit to the annual report, the Conflict Minerals Report is posted on the company’s Internet website, and that the company disclose that the Conflict Minerals Report is posted on the company’s Internet website, and provide the Internet address of that website. The SEC’s proposed rules would require a company that has concluded that its conflict minerals did originate in the Democratic Republic of the Congo countries (or a company 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 company has taken to exercise due diligence on the source and chain of custody of its conflict minerals. This 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. Further, the company 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. With respect to all of the determinations made in the Conflict Minerals Report, the company would have to exercise due diligence in making those determinations.

Section 1502 does not provide for a *de minimis* standard regarding the amount of conflict minerals that an company must use in order to be subject to the above-referenced reporting requirements. As a result, companies 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, in its proposed rules, 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.”

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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 companies in a wide variety of circumstances. While it is possible that more fully developed information and due diligence processes will be created regarding the raw materials supply chain and the sourcing of conflict minerals, companies 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 company's products.

### ***Mine Safety Disclosure***

Section 1503 of the Dodd-Frank Act established new disclosure requirements for companies that are operators, or that have a subsidiary that is an operator, of a coal or other mine. Under Section 1503, companies operating coal or other mines must include disclosures regarding health and safety violations in periodic reports, and must file a Current Report on Form 8-K to disclose receipt of certain notices or orders of mine safety violations, or a pattern of such violations. The disclosures required regarding coal or other mine safety were effective 30 days following enactment of the Dodd-Frank Act.

The disclosure requirements in Section 1503 refer to, and are based on, the health and safety requirements applicable to mines under the Federal Mine Safety and Health Act of 1977 (the "Mine Act"), which is administered by the MSHA. For the purposes of Section 1503, a "mine" is generally deemed to include "area[s] of land from which minerals are extracted in non-liquid form, or if in liquid form, are extracted with workers underground." In the spring of 2010, during the deliberation of the legislative initiatives that ultimately resulted in the Dodd-Frank Act, mine safety was a topic of close public attention following the explosion of the Upper Big Branch mine in West Virginia. In the wake of this disaster, Section 1503 significantly expanded the level of detailed information about mine safety issues that must be publicly disclosed by public companies.

The current reporting requirements of Section 1503 require each company 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: (1) an imminent danger order under Section 107(a) of the Mine Act; (2) 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 Act; or (3) written notice from MSHA of the potential to have a pattern of such violations. The periodic reporting requirements of Section 1503 have applied to any quarterly report on Form 10-Q or annual report on Form 10-K filed on or after August 20, 2010. Such reports must include the following for each coal or other mine operated by the company or its subsidiaries during the period covered: (i) 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; (ii) the total number of orders issued under Section 104(b) of the Mine Safety Act; (iii) 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; (iv) the total number of flagrant violations under Section 110(b)(2) of the Mine Safety Act; (v) the total number of imminent danger orders issued under Section 107(a) of the Mine Safety Act; (vi) the total dollar value of proposed assessments from the MSHA under the Mine Safety Act; and (vii) the total number of mining-related fatalities. In addition, a company's periodic reports must include a list of coal or other mines operated by the company (or a subsidiary of the company) 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

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as could have significantly and substantially contributed to mine health or safety hazards under Section 104(e) of the Mine Safety Act. Further, a company must disclose “[a]ny pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.”

Most of the information called for by these disclosure requirements is already publicly disclosed by MSHA and, as a result, is readily available to companies, who receive the notices, orders and citations directly from MSHA and can also access relevant information through MSHA’s data retrieval system. Further, the disclosure for periodic reports requiring disclosure of mining-related fatalities is already subject to MSHA regulations.

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. In addition to the disclosures required by Section 1503, the proposed rules require that companies describe the categories of violations, orders and citations they are reporting, so that the information provided in the reports can be understood without referencing the Mine Act and MSHA rules. With respect to the current reporting obligations under Section 1503, the proposed rules would require that a company’s Form 8-K filing specify the type of order or notice, the date of the order or notice, and the name and location of the mine involved. The SEC has proposed to add new Item 1.04 to Form 8-K, which would require filing of Form 8-K within four business days of the receipt by a company (or a subsidiary of the company) of the notices or orders discussed above. Under the SEC’s proposed rules, a late filing of the Form 8-K would not affect a company’s eligibility to use a Form S-3 short-form registration statement. Foreign private issuers would not be required to file current reports under the SEC’s proposed rules.

### **Payments to Governments by Certain Resource Extraction Companies**

Section 1504 of the Dodd-Frank Act imposes requirements on certain resource extraction companies to disclose, in their annual reports filed with the SEC, information regarding payments made by the company, a subsidiary of the company, or an entity under the control of the company, to either the U.S. Federal Government or to a foreign government for the purpose of the commercial development of oil, natural gas or minerals. 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. 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.

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.” In making this assessment, Section 1504 indicates that the SEC must consider, to the extent practicable, the guidelines set out by the Extractive Industries Transparency Initiative (“EITI”). EITI is an international organization with the stated purpose of promoting transparency and improved governance in the oil, gas and mining industries. The required disclosures under Section 1504 include the type and total amount of such payments

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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. Section 1504 provides that a payment that is of a *de minimis* amount will not require disclosure. The disclosures required under Section 1504 must be made in the company's annual report, and must be submitted to the SEC in an interactive data format.

More specifically, Section 1504 requires that the interactive data submitted to the SEC to identify, for any payments made by a resource extraction company: (1) the total amounts of the payments, by category; (2) the currency used to make the payments; (3) the financial period in which the payments were made; (4) the business segment of the company that made the payments; (5) the government that received the payments, and the country in which the government is located; (6) the project of the company to which the payments relate; and (7) any other information that the SEC considers necessary or appropriate in the public interest or for the protection of investors.

Section 1504 provides that the SEC's rules should, to the extent practicable, support the federal government's commitment to "international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals." In this regard, Section 1504 directs the SEC, to the extent practicable, to make publicly available online a compilation of the information required to be submitted pursuant to the disclosure requirements contemplated by Section 1504. Under the SEC's proposed rule and form amendments, a company 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. In addition, a resource extraction company 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. The SEC's proposed rule and form amendments would also require a resource extraction company to "provide a statement, under an appropriate heading in the company's annual report, referring to the payment information provided in the exhibits to the report." The Section 1504 payment disclosure requirements would apply to U.S. and foreign resource extraction companies as contemplated by the SEC's proposed rules. A new Item 105 to Regulation S-K proposed by the SEC would require a resource extraction company 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.

Section 1504 touches upon a sensitive area of disclosure for companies engaged in the commercial development of oil, natural gas or minerals, as payments made to the U.S. government and to foreign governments can raise a variety of issues from a business, competitive and geo-political standpoint. While initiatives have been underway to date to increase transparency in this area, Section 1504 represents the mandated use of the existing public disclosure system as a means of addressing the issue. As with Section 1502, the disclosure under Section 1504 seems largely targeted at eliciting information that has implications for public policy around the world.

The SEC has sought to in some ways to lessen the burden of the Section 1504 disclosure requirements in its proposed rules, by specifying that the payment and related information as exhibits to the annual report, for the purposes of the securities laws, will be considered to be "furnished" rather than "filed." As a result, the exhibits to be filed by resource extraction companies would not be subject to Section 18 liability under the Exchange Act. However, failure to furnish the information would subject the resource extraction company to liability under Sections 13(a) and 15(d) of the Exchange Act. The provisions of Section 1504 and the SEC's proposed rules do not require current reporting of payments of

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resource extraction companies, limiting the release of the information to an annual event and through an exhibit filing, where the risk of over-emphasis of the information is reduced.

## CONCLUSION

While much has been accomplished to date in implementing the provisions of the Dodd-Frank Act applicable to public companies, a long road of implementation remains ahead as the SEC tackles some of the most difficult and controversial provisions, such as conflict minerals and pay ratio disclosure. One year following enactment of the Dodd-Frank Act, not all of the provisions that were expected to be implemented by this time have been completed, however many of those provisions are expected to be completed later this year and could apply to filings beginning as early as 2012. We will continue to monitor the implementation of these provisions of the Dodd-Frank Act and will provide you with updates as developments happen.

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