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CORPORATE GOVERNANCE, EXECUTIVE COMPENSATION AND INVESTOR PROTECTION UNDER DODD-FRANK

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Among its many provisions, the Act includes new rules and rulemaking directives on executive compensation disclosure, corporate governance and investor protection, including:

- **Shareholder Approval of NEO Compensation (*Say-on-Pay Voting*) and Golden Parachute Compensation**. Section 951 of the Act requires companies to submit the compensation of their named executive officers to a non-binding shareholder vote at least once every one, two or three years; the frequency of such say-on-pay vote, to be determined by the shareholders at least every six years. Submission of the first say-on-pay resolution, as well as the resolution establishing the frequency of subsequent say-on-pay resolutions, are required to be included in proxy statements containing executive compensation disclosure for annual or other meetings of shareholders to be held after January 21, 2011.

Additionally, Section 951 provides that companies must disclose, and submit to a non-binding shareholder vote, the terms of golden parachute payments to be made to named executive officers in connection with a proposed acquisition, merger, consolidation or sale of all or substantially all of a company's assets for which shareholder approval is being solicited. The disclosure must be "in clear and simple form" in accordance with SEC regulations to be promulgated. The golden parachute disclosure and the resolution seeking non-binding shareholder approval must be included in proxy statements for shareholder meetings occurring after January 21, 2011, unless the golden parachute payments were subject to a prior say-on- pay vote.

Finally, Section 951 requires institutional investment managers subject to Section 13(f) of the Securities Exchange Act of 1934 to annually disclose how they voted on say-on-pay and golden parachute proposals, unless otherwise required by the SEC.

- **Compensation Committees – Independence and Authority**. Similar to the requirements of Section 10A of the Exchange Act pursuant to the Sarbanes-Oxley Act, Section 952 of the Act requires the SEC to direct the national securities exchanges to require that all compensation committee members of U.S. listed companies be independent, and directs that the national securities exchanges consider, among other factors, the source of fees paid to a director (such as any consulting, advisory or other compensatory fees paid by the company) and whether the director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company, when determining "independence". Further, the Act provides that compensation committees shall have the exclusive authority to hire compensation consultants, legal counsel and other advisers, that compensation committees shall be directly responsible for appointing, compensating and overseeing the work of these advisers, and that companies must provide compensation committees with appropriate funding (as determined by the compensation committee) to pay reasonable compensation to such advisers.

Additionally, Section 951 requires compensation committees to consider certain independence factors, to be identified (and adopted) by the SEC, when selecting a compensation consultant, legal counsel or other adviser, and directs that such factors include: (i) other services provided by the employer of the adviser to the company; (ii) the amount of fees received from the company by the employer of the adviser as a percentage of the employer's total revenue; (iii) the policies and procedures of the employer of the adviser so as to prevent conflicts of interest; (iv) business or personal relationship of the adviser with members of the compensation committee; and (v) any company stock owned by the adviser.

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Beginning with proxy statements for shareholder meetings to be held on or after July 22, 2011, companies are required to disclose whether the compensation committee retained or obtained the advice of a compensation consultant, and whether the compensation consultant's work raised any conflicts of interest and, if so, the nature of the conflict and how the conflict was (or is being) addressed.

- **Expanded Disclosure of Executive Compensation – Pay Versus Performance**. Section 953 of the Act directs the SEC to adopt rules that require companies to disclose in their annual meeting proxy statements a "clear description" of executive compensation, including information about the relationship between executive compensation actually paid and the company's annual financial performance, taking into account any change in the value of the company's stock and dividends and other distributions.

The SEC is also directed to amend Item 402 of Regulation S-K to require disclosure in statements and reports required to contain Item 402 information (including, registration statements, periodic reports filed under Section 13 or 15(d) of the Exchange Act, tender offer statements and annual meeting proxy statements), (i) the median annual total compensation of all company employees, excluding the chief executive officer; (ii) the chief executive officer's annual total compensation; and (iii) the ratio of the median annual total compensation of all company employees to the chief executive officer's annual total compensation.

- **Policy Disclosure and Clawback Provisions**. Pursuant to Section 954 of the Act, the SEC is required to direct the national stock exchanges to prohibit the listing of any security of a company that fails to develop and implement policies providing for (i) the disclosure of the company's incentive based compensation policies for executive officers based on disclosed financial information; and (ii) the recovery of any incentive based compensation (including stock options) paid to current or former executive officers in the event the company is required to restate its financial statements as a result of the company's material noncompliance with the financial reporting requirements of the securities laws. The look back, recovery period is three years and the amount recoverable is the excess of what would have been paid to the executive officer based on the restated financial information.

Currently, pursuant to the Sarbanes-Oxley Act, a company's chief executive officer and chief financial officer are required to forfeit any bonus or other incentive/equity-based compensation received and profits realized from the sale of the company's securities, in the event the company is required to restate its financial statements due to the material noncompliance by the company as a result of misconduct, with any financial reporting requirements under the securities laws. The Act expands the class of officers subject to clawback, extends the look back, recovery period (from 12-months), and removes the requirement of "misconduct".

- **Disclosure of Hedging Policies**. Section 955 amends Section 14 of the Exchange Act to require the SEC to adopt rules requiring companies to disclose in their annual meeting proxy statements whether their employees or directors, or any of their designees, are permitted to engage in hedging transactions in the company's equity securities (including the purchase of prepaid variable forward contracts, equity swaps, collars, and exchange funds). Actual hedging transactions need not be disclosed. Item 403 of Regulation S-K currently requires companies to disclose whether their executive officers and directors have pledged any shares, and Item 402 of Regulation S-K currently includes a discussion of hedging policies as one of the items that companies should discuss in their Compensation Discussion and Analysis.

- **Further Restriction on Broker Discretionary Voting**. Section 957 of the Act amends the Exchange Act to prohibit discretionary voting by brokers with respect to the election of directors, executive compensation matters and on any other significant matter as determined by the SEC. Although the effective date of this provision is not specified, on August 4, 2010, the NYSE issued an "Information Memorandum" to its members and listed companies advising them that the NYSE will prohibit its member brokers from voting uninstructed shares if the matter to be voted on relates to executive compensation, including say-on-pay proposals, at meetings occurring after July 21, 2010. The NYSE stated that while the rulemaking process was ongoing, it would begin to immediately treat executive compensation matters for which member organizations had previously been allowed to vote uninstructed shares, as "may not vote" rulings going forward. Therefore, brokers currently may not vote uninstructed shares in a proxy vote involving executive compensation matters, unless the NYSE has issued a "may vote" ruling for the effected shareholder meeting prior to July 21, 2010.

- **Proxy Access**. Section 971 amends the Exchange Act to authorize, but not require, the SEC to prescribe rules and regulations permitting shareholders to include their director nominees in a company's proxy statement for its annual meeting of shareholders.

On August 25, 2010, the SEC adopted final rules[1] amending the proxy rules, including adding new proxy rule, Rule 14a-11, to facilitate shareholder nominations. Rule 14a-11 requires companies to provide shareholders with information about, and the ability to vote for, shareholder nominees for director in their proxy materials. This requirement will apply unless state law, foreign law, or a company's governing documents prohibits shareholder nominations for directors. Current proxy rule, Rule 14a-8(i)(8), is amended to preclude companies from relying on Rule 14a-8(i)(8) to exclude from their proxy materials shareholder proposals by qualifying shareholders seeking to establish a procedure under a company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials. A company must include such a shareholder proposal under the final rules as long as the procedural requirements of Rule 14a-8 are met and the proposal is not subject to exclusion under one of the other substantive bases. See our Securities Law Information Memo, "*SEC Final Rules: Shareholders Right to Nominate Directors,*" September 2010.

- **Board Leadership Disclosure**. Section 972 of the Act requires the SEC to issue rules (no later than January 17, 2011) that require disclosure in the annual meeting proxy statement as to why the same person or different persons serve as the company's chief executive officer and chairman of the company's board of directors. Item 407 of Regulation S-K, as recently amended[2] requires companies to include a discussion of their leadership structure in their proxy statements, including a discussion as to whether and why a company has chosen to combine or separate the principal executive officer and board chairman positions.

- **Permanent Relief From Auditor Attestation of Internal Control**. Section 989G of the Act provides a permanent exemption from the internal control auditor attestation requirements under Section 404(b) of the Sarbanes-Oxley Act. The exemption applies to non-accelerated filers (including smaller reporting companies) and larger companies whose only public securities are debt securities, and is effective July 21, 2010.

- **Revisions to "Accredited Investor" Definition**. Section 413 of the Act, amends the definition of "accredited investor" under Rule 501 of Regulation D to exclude the value of a person's primary residence for purposes of the $1,000,000 net worth calculation. The change is effective July 21, 2010.

If you have any questions, please contact
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[1] SEC Release No. 33-9136, Facilitating Shareholder Director Nominations (August 25, 2010).
[2] SEC Release No. 33-9089, Proxy Disclosure Enhancements (Effective February 28, 2010).