Weil Briefing:
SEC Disclosure and Corporate Governance

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Challenges of the Next Proxy Season:
What to Expect from the Dodd-Frank Act and How to Begin to Prepare

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, signed into law yesterday, restructures the regulatory framework for the U.S. financial system.[1] While most of its 2,300 pages focus on the financial services industry, the Dodd-Frank Act also contains provisions intended to strengthen corporate accountability to shareholders that will affect all U.S. public companies regardless of industry. Many observers believe that implementation of the Dodd-Frank Act will significantly increase the influence of shareholders in corporate governance matters -- beginning with the 2011 proxy season.

Key governance and disclosure provisions of the Dodd-Frank Act include:

- express authority for the Securities and Exchange Commission to adopt proxy access rules
- mandates for shareholder advisory votes on executive compensation
- further limits on discretionary voting by brokers
- new “pay vs. performance” and “pay equity” disclosures
- heightened independence requirements for compensation committees and their advisers
- required clawback policies that reach beyond the Sarbanes-Oxley Act
- new disclosure of corporate policies on hedging by directors and employees
- enhanced incentives and protections for corporate whistleblowers
- authority for the SEC to adopt rules increasing the transparency of securities ownership

Many important aspects of these provisions await rulemaking by the SEC and national securities exchanges. This Briefing is intended to give chief legal officers, corporate secretaries and others in management who work with their company’s board a head start in planning to meet the considerable challenges stemming from the Dodd-Frank Act for the upcoming proxy season. We hope it will be helpful in advising directors on the new decisions they will be required to make and in reviewing board processes to account for the increased workload.

This Briefing also discusses the SEC’s recently announced review of the U.S. proxy voting system, which has the aim, closely related to the Dodd-Frank Act, of enhancing the accuracy and integrity of the shareholder voting process.

Our readers should also take note of the impact on boards and shareholders that may come indirectly from the array of provisions that will increase financial and market transparency, such as increased regulation of derivatives trading, hedge funds, private equity funds and credit rating agencies. For information about the entire Dodd-Frank Act, please see “An Overview of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010” (July 21, 2010), available at http://financial-reform.weil.com/wp-content/uploads/2010/07/Weil-Dodd-Frank-Overview_2010-07-21.pdf.

Table of Contents

What to Expect from the Dodd-Frank Act for the 2011 Proxy Season . . .

The new requirements of the Dodd-Frank Act and current trends in shareholder activism are likely to combine to make the 2011 proxy season unlike any before in terms of the range of matters on which boards will need to elicit shareholder support and the level of shareholder engagement:

- **Proxy Access:** We expect the SEC to act promptly to give substantial shareholders or shareholder groups the ability to include their nominees for a limited number of board seats in the company's proxy materials. Interest in access is evidenced by the efforts of some institutional shareholders to create databases of potential director candidates. For calendar year companies, we expect the deadline to submit shareholder nominations for inclusion in company proxy materials to be around year-end, subject to the terms of advance notice bylaws (which may need to be reset when the new rules are adopted).
- **"Say-on-Pay" Votes:** Subject to exceptions the SEC may create, companies will be required to seek a non-binding shareholder vote on the compensation package of their named executive officers at their first meeting held on or after January 22, 2011. This first year, and at least once every six years thereafter, companies will also be required to seek a vote on whether such "say-on-pay" votes should occur every one, two or three years. Note that, in the 2010 proxy season, of 125 management proposals by TARP recipients and other companies seeking an advisory vote on executive compensation, 122 received majority support, with approval averaging more than 74% of the votes cast.[2]
    - Expect continued and perhaps even greater shareholder scrutiny of compensation committee decisions and independence, committee adviser independence, and the pay-performance link (especially for CEOs), all of which will be highlighted by the Dodd-Frank Act's new disclosure requirements and could influence say-on-pay votes.
- **No Broker Discretionary Voting:** We expect the SEC and stock exchanges to act promptly so that, in addition to the existing bar on broker discretionary voting for the election of directors, brokers will not be able to vote customer shares without customer instructions on say-on-pay proposals (and perhaps other matters the SEC deems "significant"). We expect this bar to be followed by most if not all bank custodians as well, absent contractual arrangements to the contrary.
- **Shareholder Proposals on Governance:** Expect access and say-on-pay votes to play out in the context of continuing shareholder proposals on governance issues. In the 2010 proxy season, 35 proposals to separate the positions of Chairman and CEO received an average of 28% support;[3] 31 proposals requiring majority voting in uncontested director elections received an average of 57% support, with 19 receiving a majority of votes in favor; 43 board declassification proposals received an average of 62% support, with 29 receiving a majority of votes in favor; and 43 proposals seeking to establish a shareholder right to call a special meeting received an average of 43% support, with 12 receiving a majority of votes in favor.[4] Also expect an increase in shareholder proposals relating to CEO succession and risk management now that the SEC staff's liberalized position on inclusion will be available for a full season.[5]

. . . And How to Begin to Prepare

We recommend that chief legal officers, corporate secretaries and others in management work with their boards on these and other more specific steps discussed later in this Briefing:

- **Educate Directors and Senior Management:** Ensure that senior management and the board are up to speed on the new requirements and understand the heightened pressures. Work with the board to revise its calendar to ensure that the board and its committees have sufficient time to tackle the new requirements.
- **Help Shape the Rulemaking Needed to Implement the Dodd-Frank Act:** Review SEC and stock exchange rule proposals as published for comment, and consider whether to comment on them, either individually or through industry groups or coalitions.
- **Focus on Shareholder Relations:** In the period leading up to proxy access and, for most companies, first time say-on-pay votes, reassess the company's approach to shareholder relations. (For suggested questions to ask, see Appendix B.)
    - Ensure that information systems and communications programs enable management and the board to identify and respond readily to shareholder concerns. Know who your large owners are -- the top twenty or thirty shareholders -- and consider whether to reach out to them in advance of the next meeting to find out what their concerns are, especially with regard to board composition and executive compensation.
    - Ensure that investor relations personnel are well-versed on institutional investor and proxy advisor positions on "hot button" issues -- as well as the company's rationale where its approach departs from these positions.
    - Ensure that the company's investor communications policy is up-to-date and well-understood by directors and senior management as well as investor relations personnel.[6]
    - Consider extra efforts to encourage retail shareholders to vote.
- **Review Compensation Committee Membership and Advisers:** To determine whether any changes are likely to be needed to pass forthcoming independence tests, assess the independence of the board's current compensation committee members applying the independence tests for audit committee members and for advisors apply the general conflict-of-interest disclosure criteria prescribed by the Act for compensation consultants.
- **Review Compensation Program and Disclosures.** Evaluate the company's executive compensation program and disclosures from a shareholder perspective, recognizing that they will be put to the test in say-on-pay votes. Focus once again on whether there are any compensation elements that may lead to inappropriate risk-taking. Focus on what the new "pay vs. performance" disclosure will reveal. Management and the compensation committee should take a fresh look at this year's CD&A to ensure it explains in a clear and convincing way what the company's compensation philosophy is, how (and how independently) its compensation processes are conducted and the "why" of specific compensation decisions.
    - Consider whether to recommend to shareholders a say-on-pay vote every one, two or three years.
- **Recalibrate Disclosure Controls and Procedures:** Review and adjust disclosure controls and procedures to capture the additional information that is required to be disclosed.

I. INTRODUCTION

A. Background of the Dodd-Frank Act

In the wake of the financial crisis and in a political environment highly distrustful of corporate boards and executives, Congress considered multiple bills proposing a wide variety of corporate governance and disclosure reforms to address perceived failings of corporate accountability. Supporters of new federal governance mandates contended that federal mandates are necessary to hold boards of directors accountable to shareholders. Opponents countered that federal mandates represent an ill-advised departure from the flexible state law-based system that has avoided a one-size-fits-all approach in favor of private ordering. They noted the success in recent years of shareholder initiatives on issues such as majority voting in uncontested director elections, which has now been implemented at 71% of the S&P 500.[7]

The Dodd-Frank Act represents a compromise between those in the investor community who have sought enforced governance reforms, and those who favor private ordering. Some widely discussed potential mandates -- majority voting for directors, limits on executive compensation, and board risk committees for non-financial companies -- did not make their way into the final legislation. As discussed below, however, the Act makes many changes that proponents hope will foster greater transparency for shareholders and give shareholders a greater voice in corporate governance.

B. Relationship of the Dodd-Frank Act to State Law and its Implications for Directors

Corporate governance and other matters relating to the internal corporate affairs of U.S. companies have historically been governed by the law of the state of incorporation. Similar to what the Sarbanes-Oxley Act did with respect to audit committees, the Dodd-Frank Act mandates a number of governance structures and practices that traditionally have been regulated only by state law. These include: proxy access, “say-on-pay” and “golden parachute” votes, compensation committee and committee adviser independence, incentive compensation “clawback” policies and special governance requirements for financial companies.

As a result of the Dodd-Frank Act, boards of directors will need to oversee management’s compliance with a panoply of new regulations, adding to what is already a very full plate. Boards also will need to be aware of reforms that directly affect their own composition and processes. Significantly, however, the Act’s provisions concerning say-on-pay votes and compensation committee advisers expressly disclaim any intention “to create or imply any change to the fiduciary duties of directors” or “to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.” Bottom line, the Dodd-Frank Act does not alter or eliminate the protections traditionally provided to directors by the business judgment rule.

II. Impact on Shareholder Meetings

The Dodd-Frank Act includes several provisions that proponents hope will, in combination, give investors a greater voice in board composition and executive compensation.

A. Proxy Access Rulemaking Authority (§ 971)

Whether and under what circumstances shareholders should be able to use company proxy materials to solicit votes for shareholder nominees -- significantly lowering the cost of running an election contest -- has been a matter of substantial debate. Most recently, in June 2009, the SEC issued proposed rules that would require a company to include in its proxy materials, at the company's expense, director nominees submitted by a shareholder or group of shareholders satisfying certain eligibility standards: ownership, for at least one year, of 1% of voting securities of large accelerated filers, 3% of voting securities of accelerated filers or 5% of voting securities of nonaccelerated filers, as long as the shareholder or group is not seeking to change control of the company. The SEC's June 2009 proposed rules would also require a company to include in its proxy materials a shareholder proposal concerning nomination procedures or disclosures regarding nominations, including a proposal seeking access, as long as the proposed action would not conflict with the new access rules and complies with the requirements for shareholder proposals set forth in Rule 14a-8 under the Securities Exchange Act of 1934, as amended.[8]

The SEC received hundreds of comments on its proxy access proposal. In December 2009, it decided to reopen the comment period (which finally ended on January 19, 2010) to enable comment on several reports dealing with, among other things, the limits on creating proxy access by private ordering and the possible impact of an access rule on competitiveness and efficiency. In June 2010, SEC Chairman Mary L. Shapiro confirmed her commitment "to bring a proposal back to the Commission to consider final adoption, within a timeframe that would put the [access] rules into effect for the 2011 proxy season."[9]

The Dodd-Frank Act is intended to resolve the controversy over whether the SEC is authorized to issue proxy access rules by giving the SEC express discretionary authority to adopt rules that require inclusion of shareholder director nominees in a company's proxy solicitation materials and that establish procedures related to such a solicitation. In light of this, we expect the SEC to move quickly to fulfill the Chairman's commitment. Under the Act, the SEC may provide access on terms and conditions that it determines to be in the interests of shareholders and for the protection of investors. During the conference committee reconciliation process, Senator Dodd proposed requiring a minimum 5% threshold and two-year holding period as conditions for access. This was rejected, leaving the share ownership threshold and holding period, along with all other terms of access, to SEC rulemaking. The SEC has express discretion under the Act to consider exemptions based on factors such as the potential for disproportionate burdens on small companies.

- ***Actions to Take***:
  - Although the terms of the SEC access rules are not yet known, it is timely for the board and particularly its nominating and governance committee to consider the nomination process and what changes may be advisable for a world in which nominees not selected by the board may be presented to shareholders in company proxy materials.
  - Examine advance notice bylaws. They will become important as a practical matter if, as proposed, the final rule incorporates as a deadline for making an access nomination the last date for submission of a nomination under the company's advance notice

bylaw (or 120 calendar days prior to the annual meeting when no such bylaw is in effect). Advance notice bylaws customarily require notice of nominations to be provided during the 60 or 90 day period prior to the annual meeting date. This may not be workable for an access nomination in the event, as proposed, a dispute over eligibility is to be resolved by the SEC through the no-action process.

B. Votes on Executive Compensation (§ 951)

(1) Say-on-Pay and Say-When-on-Pay

The Dodd-Frank Act amends the Exchange Act to require companies to provide for an advisory shareholder vote on the compensation of executives as disclosed pursuant to SEC rules. Although this "say-on-pay" vote is not binding on the company, it will likely apply greater pressure on boards to consider shareholder viewpoints in making executive compensation decisions. If a majority or, perhaps, a smaller but still large number of shareholders vote against the disclosed compensation and the board does not respond with changes, it is likely that the compensation committee members will face a withhold vote effort on their re-election. The executive compensation and compensation committee independence disclosures required by the Act, which are described in Parts III and IV below, will add to the range of information to be considered by shareholders (and their proxy advisors) in deciding how to vote.

The "say-on-pay" vote must occur annually, biennially, or triennially, as determined by a separate shareholder vote held at least once every six years, at an annual or other meeting for which executive compensation disclosure is required by SEC rules to be included in the proxy statement (a "frequency" or "say-when-on-pay" vote). Both votes are required to be included in the company's proxy statement for the first annual or other meeting of shareholders occurring on or after January 22, 2011.

A number of interpretive issues arise, which the SEC may, but is not required to, address in rulemaking:

- *What should be the text of the say-on-pay vote resolution?* Companies are likely to follow the model of the Troubled Asset Relief Program (TARP) recipient companies, which are (and last year were) required to have a say-on-pay by the Emergency Economic Stabilization Act of 2008.[10] We expect the SEC to adopt a rule similar to Rule 14a-20 under the Exchange Act, which provided that TARP recipients were required to "have a separate shareholder vote to approve the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K."
- *What should be the text of the "frequency vote" resolution?* It appears from the Dodd-Frank Act that shareholders will need to be presented with all three choices: annual, biennial, or triennial say-on-pay votes. We expect that the board of directors would recommend one of them.
- *Is the" frequency vote" binding on the company or board?* The Dodd-Frank Act indicates that it is not binding, but a contrary interpretation of the text can be argued. In any event, we would expect most companies to follow the shareholder preference indicated by the vote.
- *How is the "frequency vote" to be obtained and interpreted by the board?* It is not clear. A say-when-on-pay vote may need to be implemented through three separate votes: choosing "for," "against," or "abstain" on each of annual, biennial, or triennial

alternatives. Although this method makes little common sense (a stockholder could vote "for" each of them), it may be necessitated by current SEC rule and Broadridge system requirements. Whichever of the three alternatives received the most "for" votes would indicate the shareholders' choice, and the board could take this tabulation into consideration.

- *Will a preliminary proxy statement filing with the SEC be required as a result of including any of these votes?* Yes, unless the SEC advises to the contrary. Although the SEC has not spoken, we expect it will adopt an amendment to Exchange Act Rule 14a-6(a) to avoid preliminary filings, consistent with the rule change it made last year for TARP companies confronted with the same issue.

The Dodd-Frank Act provides that say-on-pay and say-when-on-pay (as well as the golden parachute votes discussed below) may not be construed in any of the following ways: (a) as overruling a decision by the issuer or board of directors; (b) to create or imply any change to or additional fiduciary duties of the issuer or board of directors; or (c) to restrict or limit the ability of shareholders to make their own proposals for inclusion in proxy materials related to executive compensation. The SEC is authorized to create exemptions from these additional votes and the disclosures discussed below, and is instructed to consider an exemption for small companies that might be disproportionately affected by these new requirements.

(2) Golden Parachutes in M&A Transactions

The Dodd-Frank Act also targets executive "golden parachutes," requiring certain disclosures and a non-binding separate shareholder vote in any proxy or consent solicitation for a meeting of shareholders occurring on or after January 22, 2011, at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the company's assets.

- There must be disclosure in a "clear and simple form," in accordance with rules to be issued by the SEC, of (a) any agreements or understandings with any named executive officer concerning any type of compensation (whether present, deferred or contingent) that is based on or otherwise relates to the M&A transaction and (b) the aggregate total of all such compensation that the officer may be paid (and the conditions of such payment). Although we will need to await future SEC rulemaking, it is possible that such rules could take an approach to the required disclosure similar to that required under Item 402(j) of Regulation S-K (the "Potential Payments Upon Termination or Change-in-Control" section of the annual proxy statement) but as of a recent date (rather than the end of the year) and also require tabular presentation.
- The non-binding vote to approve the agreements or understandings and compensation, as disclosed, is not required if the agreements and understandings have been already subject to a "say-on-pay" vote. Note that this exception does not obviate the required "clear and simple form" disclosure.
- These additional disclosures could highlight "excessive" arrangements in the context of an M&A transaction, but it is not clear what impact, if any, a potential separate non-binding vote on such arrangements would have on M&A practice.

(3) Disclosure of Votes by Institutional Investment Managers

The Dodd-Frank Act also amends the Exchange Act to require every institutional investment manager subject to section 13(f) of the Exchange Act (*i.e.*, institutional investment managers exercising investment discretion over U.S. public company equity securities and certain other securities with an aggregate fair market value of at least $100 million) to report at least annually with respect to how it cast its votes on say-on-pay, say-when-on-pay and golden parachute resolutions. We expect that the SEC will issue rules addressing where and how this disclosure should be made.

- ***Actions to Take***:
  - Review compensation committee calendars to ensure, this first season, that say-on-pay and say-when-on-pay are included on the agenda well in advance of the time the committee typically addresses annual meeting proxy issues.
  - Review and amend compensation committee charters to require the committee to consider say-on-pay, say-when-on-pay and golden parachute resolutions both before and after the votes required by the Dodd-Frank Act.
  - Consider what frequency to recommend for the say-on-pay vote. Given the complexity of compensation plans and the fact that they often are designed to induce and reward performance over a multi-year period, boards may wish to consider proposing to shareholders that the advisory vote be held every two or three years rather than every year. Some shareholders are likely to support holding such vote on a less frequent than annual basis. For example, a triennial vote is favored by the United Brotherhood of Carpenters and other institutional investors who are concerned about the demands the new vote will place on them to analyze CD&As for all the companies in their portfolios.
  - Now more than ever companies need to know and consider the "hot buttons" of their shareholders and proxy advisors with respect to compensation, keeping in mind that broker discretionary voting will no longer be available for say-on-pay (see II.C. below). For many companies, as a practical matter, their executive compensation practices and disclosures may need to satisfy RiskMetrics' voting guidelines -- for if they do not, a company risks a substantial stockholder vote "against" pay. If RiskMetrics' perceived "offensive practices" remain unremedied, the company further risks an eventual withhold or against vote in the election of the compensation committee or board of directors.

C. Further Limitation of Broker Discretionary Voting (§ 957)

For the 2010 proxy season, the New York Stock Exchange eliminated broker discretionary voting in uncontested director elections, as it had done some years earlier on compensation plans involving share issuances. The Dodd-Frank Act goes further, requiring national securities exchanges to prohibit member brokers from voting customer shares, without first receiving voting instructions from the beneficial owner, with respect to:

- director elections (other than uncontested elections at registered investment companies),
- executive compensation and
- any other "significant matter,"

all as determined by the SEC by rule. This will reduce the number of shares voted by brokers without instructions, traditionally voted in a management-friendly way. The same voting practices are likely to be followed by bank custodians, consistent with current practices. Since, as noted above, the NYSE already bars broker discretionary voting on share compensation plans and in uncontested director elections, the principal effects of this provision are to prevent brokers from voting uninstructed shares on a "say-on-pay" proposal and on the approval of a solely cash-based compensation plan. The Dodd-Frank Act does not specify a rulemaking deadline, but we expect this requirement to be in place not later than the 2011 proxy season.

- ***Actions to Take***:
  - Broker shares held for customer accounts, even though the broker has not received voting instructions, are usually represented at shareholder meetings and are counted for quorum purposes so long as there is at least one "routine" item to be voted upon at the meeting on which such shares are permitted to vote. Companies that have a large number of retail investors may face problems achieving a quorum at meetings unless there is a routine matter on the agenda. This past season, though uninstructed voting on the election of uncontested elections was, for the first time, not permitted by the NYSE, the ratification of auditors was still considered a routine item under NYSE Rule 452. We expect that, to help ensure that meeting quorums can be achieved, the SEC will not use its new authority to deem ratification of auditors a "significant matter."
  - Those companies having a significant retail shareholder base that have adopted the "notice-only" alternative available under the SEC's e-proxy rules -- under which companies refer shareholders to proxy materials available online rather than physically delivering hard copies -- may wish to reconsider use of this alternative given the significant drop in voting participation by retail investors that has been associated with the "notice-only" option. Companies may wish to provide traditional "full set delivery" for retail shareholders, and use "notice-only" for institutional investors.
  - Consider undertaking extra solicitation efforts to encourage retail shareholders to vote, including lengthening the solicitation period and providing incentives in a "get out the vote" campaign. For example, Prudential Financial, Inc. encouraged greater shareholder voting at its 2010 annual meeting by offering to plant a tree for or send an eco-friendly bag to each shareholder who voted. The initiative was reported to be a success -- the number of registered shareholders voting at the 2010 meeting increased by 23% compared to 2009, and 68,000 registered shareholders voted in 2010 who did not vote in 2009.[11]

III. New Executive Compensation Disclosures (§ 953)

The Dodd-Frank Act adds to what seems to be an almost continual torrent of new executive compensation disclosure rules by requiring the SEC to issue rules requiring reporting companies to include both "pay vs. performance" and internal "pay equity" disclosures in certain filings. The pay vs. performance provision could have far-ranging disclosure implications but, alternatively, could turn out to be relatively straightforward to prepare. The pay equity requirement looks deceptively simple but is fraught with compliance difficulties.

A. Pay vs. Performance Disclosure

Under the pay vs. performance provision, the SEC must issue rules requiring proxy statements for annual meetings of shareholders to "include a clear description of any compensation required to be disclosed" under Item 402 of Regulation S-K, "including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer" taking into account changes in stock price, dividends and distributions. At a minimum, the SEC will need to address such issues as: whose and what "executive compensation" is to be compared to financial performance, what does "actually paid" mean, how is a company's "financial performance" to be measured and what time periods are required to be covered. It remains to be seen from future rulemaking whether the SEC will use this opportunity to make more significant changes in its current disclosure rules (which already require in CD&A a discussion of pay for performance) by, for example, further limiting non-disclosure of confidential performance targets. Or whether the Dodd-Frank Act may lead to not much more than requiring an enhanced version of the five-year stock performance graph in the proxy statement (rather than in the annual report to shareholders, where it is currently required).

B. Pay Equity Disclosure

Under the pay equity provision, the SEC must issue rules requiring disclosure in certain SEC filings of (a) the *median* of the annual total compensation of all the company's employees except the CEO, (b) the annual total compensation of the CEO, and (c) the ratio of (a) to (b). This looks simple, but:

- *In what filings is the disclosure required to be made?* One read of the Dodd-Frank Act suggests that disclosure is required in just about every type of filing: not only in proxy statements and Form 10-Ks, but also in Form 10-Qs, Form 8-Ks, registration statements, tender offer statements, *etc*. Hopefully, SEC rulemaking will be able to narrow this down to only filings that include compensation disclosure required by Item 402 of Regulation S-K or even a smaller subset (such as the proxy statement and Form 10-K).
- *How is the calculation of the median total compensation of all the company's employees except the CEO to be performed?* According to the Dodd-Frank Act, the total compensation of each employee is determined in the same way that "total compensation" for a named executive officer is calculated in the Summary Compensation Table, using the SEC rules as in effect the day before the Act's enactment. Companies often struggle to determine total compensation (under the quirks of the SEC rules) for each named executive officer. For each employee in the entire workforce, the additional effort needed and the expense will no doubt be significant. Companies also will need to apply the SEC rules in effect prior to enactment, even if the SEC makes changes to its rules afterwards -- a mixed blessing. There are numerous other issues, like how to account for part-year or part-time employees and what to do if there is more than one CEO during the year. Again, we can only hope that eventual SEC's rulemaking will make preparing this disclosure less burdensome.

The Dodd-Frank Act does not include a deadline for rulemaking with respect to these new disclosures. Chairman Schapiro has indicated that this rule is unlikely to be in place for the 2011 proxy season.[12] If that turns out to be the case, companies will have more time to evaluate the capability of their payroll reporting systems to provide the needed information -- and to ponder the attention that pay equity disclosures will attract from the media and their workforce.

IV. Independence of the Compensation Committee and its Advisers

The Dodd-Frank Act includes provisions that require heightened independence of compensation committee members and the advisers the committee retains and strengthens the committee's exclusive authority over its advisers. These provisions are similar in many respects to the reforms focused on the audit committee that were ushered in by the Sarbanes-Oxley Act in the wake of financial reporting scandals.

A. Independence of Compensation Committee Members (§ 952)

The Dodd-Frank Act requires the SEC to direct national securities exchanges to require that a listed company's compensation committee members each satisfy a heightened standard of independence. This standard, which is to be set by the exchanges in accordance with SEC rules, must consider relevant factors, including the receipt of consulting or advisory fees and "affiliate" status. The standard is, therefore, expected to be very similar to that currently applicable to audit committee members.[13] If that is the case, directors who are themselves greater than 10% shareholders or who are executive officers of greater than 10% shareholders, including private equity funds, will no longer be eligible for compensation committee membership. An opportunity to cure defects in independence must be provided, and we expect the national securities exchanges to issue similar cure provisions to those currently applicable to audit committee members (for example, enabling a committee member to remain on the committee for a period of time after ceasing to be independent for reasons outside his or her reasonable control).[14]

Controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end registered management investment companies and foreign private issuers that provide annual disclosure to shareholders of reasons why they do not have an independent compensation committee are exempt from this requirement. National securities exchanges may also exempt (a) a particular relationship if appropriate taking into consideration the size of an issuer and any other relevant factors, and/or (b) a category of issuers, taking into account the potential impact on smaller issuers. The SEC must issue rules prohibiting the continued listing of companies that do not meet these independence requirements no later than July 16, 2011.

- ***Actions to Take***:
    - Because of the expected similarity of the new compensation committee independence rules to those governing audit committee independence, we suggest reviewing current compensation committee members using an audit committee lens to see if any changes to compensation committee membership are likely to be warranted.
    - Review and amend D&O questionnaires to capture information required to determine independence once the new rules are issued.
    - Review and amend compensation committee charters to reflect heightened independence requirements in committee membership criteria once the new rules are issued.
    - Nasdaq companies that authorize independent directors to provide oversight of executive officer compensation without being constituted as a compensation committee should consider establishing a compensation committee (we note that forthcoming Nasdaq listing rules may require this).

B. Committee Authority Over its Advisers (§952)

The Dodd-Frank Act requires the SEC to direct national securities exchanges to require each listed company to authorize its compensation committee, in its sole discretion, to appoint, compensate and provide oversight of the work of compensation consultants, independent legal counsel for the committee and other committee advisers, and to provide for appropriate funding for payment of reasonable compensation to these advisers. Under the Act, this requirement cannot be construed to require the compensation committee to implement or act consistently with the advice or recommendations of its advisers, or to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of its duties.

"Controlled companies" are exempt from these requirements and the SEC may allow the exchanges to exempt other categories of companies, particularly taking into account the potential impact on smaller issuers. The SEC must issue rules prohibiting the continued listing of companies that do not meet these requirements no later than July 16, 2011.

- ***Actions to Take***:
  - Review and amend compensation committee charters as needed to reflect the mandated authority of the compensation committee, in its discretion, to appoint, compensate and provide oversight of the work of compensation consultants, independent legal counsel and other advisers, and to provide for appropriate funding for payment of reasonable compensation to such advisers.

C. Independence of Committee Advisers (§952)

The Dodd-Frank Act requires the SEC to direct national securities exchanges to require that, before selecting an adviser, the compensation committee of each listed company must consider various factors bearing on independence to be identified by the SEC. These factors must include: (a) the provision of other services to the company by the person that employs the compensation consultant or other adviser; (b) the amount of fees received from the company by the person that employs the compensation consultant or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant or other adviser; (c) the policies and procedures of the person that employs the compensation consultant or other adviser that are designed to prevent conflicts of interest; (d) any business or personal relationship of the compensation consultant or other adviser with a member of the compensation committee; and (e) any stock of the company owned by the compensation consultant or other adviser. The factors must be competitively neutral among categories of consultants, legal advisers and other advisers.

"Controlled companies" are exempt from these requirements and the SEC may allow the exchanges to exempt other categories of companies, taking into account the potential impact on smaller issuers. The SEC must issue rules prohibiting the continued listing of companies that do not meet these requirements no later than July 16, 2011.

The SEC must also direct the national securities exchanges to require that each listed company disclose in its annual meeting proxy statement whether the compensation committee retained a compensation consultant, whether the work performed by such consultant raised a conflict of interest, and, if so, the nature of such conflict and how it is being addressed. This disclosure must be included in proxy statements for annual meetings held on or after July 21, 2011. The required disclosures are largely similar to those currently required concerning the independence of compensation consultants, as mandated by the "proxy disclosure enhancements" adopted by the SEC in time for the 2010 proxy season.

- ***Actions to Take***:
    - Review current relationships between the company and compensation committee members with compensation consultants and other advisers, including the provision of other services to the company, stock ownership and business or personal relationships. Revise the D&O questionnaire to capture such relationships.
    - Consider adopting a policy governing the independence of compensation consultants, legal counsel and other compensation committee advisers. This policy could be incorporated into the compensation committee charter.
    - Establish procedures for the compensation committee to follow when retaining advisers to ensure that independence requirements are met.

V. Other Key Governance Provisions

The Dodd-Frank Act includes a variety of other provisions that will have a significant effect on the governance of all U.S. companies, either because they are directly applicable or because they may influence what is ultimately considered "best practice."

A. **Incentive Compensation Clawback Policies** (§ 954)

The Dodd-Frank Act requires the SEC to instruct national securities exchanges to require each listed company to develop, implement and disclose a "clawback" policy meeting prescribed criteria. Under the mandated policy, if a company is required to restate its financial statements due to material noncompliance with financial reporting requirements under the securities laws, the company must recover from current and former executive officers (not just named executive officers) any incentive compensation (including stock option awards) that is (a) based on the erroneous data, (b) received during the three-year period preceding the date on which the company becomes required to prepare the restatement, and (c) in excess of what would have been paid if calculated under the restatement.

This new listing standard will generally be far broader than the clawback provision in Section 304 of the Sarbanes-Oxley Act. Under the Sarbanes-Oxley Act provision, the SEC (but not the company or its shareholders) may seek to recoup from the CEO and CFO only, for the company's benefit, any of their incentive compensation received, or profits realized from equity transactions, during the 12 month period following the initial publication of the financial statements that had to be restated, where the restatement resulted from misconduct (although not necessarily that of the CEO or CFO). The new listing standard also goes beyond the practice of most companies that have voluntarily adopted clawback policies. The Dodd-Frank Act does not specify a rulemaking deadline for the SEC and, given the rulemaking that the SEC must or will want to complete in time for the 2011 proxy season, it is possible that the rulemaking process could extend into 2011.

Like with many provisions of the Dodd-Frank Act, the "devil will be in the details." Here are a number of issues:

- Will there be retroactive applicability to outstanding awards granted before the rule comes into effect and, if so, how will companies obtain recovery (there could be contractual or legal obstacles)?
- What does "material noncompliance" mean?
- How is excess compensation to be determined in the case of equity, where values change?
- How is excess compensation to be determined when a discretionary bonus was based significantly on erroneous earnings but there is no direct correspondence between the amount of the bonus and specific earnings levels?
- When is the date a company is "required to restate," which starts the three-year clock running? (Is it the date of publication of the erroneous financial statements as under the Sarbanes-Oxley Act but, if so, why stated so differently?)
- Will a company face potential delisting if it does not pursue recovering $2,000 excess compensation from a former executive officer who is innocent of misconduct, or if it recovers less than the full amount (and did not pursue a lawsuit)?

NYSE and Nasdaq both require their listed companies to provide the exchange with prompt notification after an executive officer becomes aware of any noncompliance (NYSE) or material noncompliance (Nasdaq, soon to be any noncompliance) by the company with the corporate governance listing standards. It is possible that the future rule associated with this provision will offer few details beyond the Dodd-Frank Act[15] and therefore could provide companies with considerable but potentially uneasy leeway.

- ***Actions to Take***:
  - Review existing policies and agreements relating to recoupment of incentive executive compensation, and consider the changes that will be necessary to meet the new requirements.
  - Pending adoption of the new listing rule, companies should consider including in any new plans or incentive awards a provision that permits the company to clawback the award to the extent clawback is required by the future listing rule or is required under the current Sarbanes-Oxley Act clawback provision or by either of these as they may be amended from time to time.

B. Disclosure of Permissibility of Hedging by Directors and Employees (§ 955)

Under the Dodd-Frank Act, the SEC must issue rules requiring companies to disclose in their annual proxy statements whether any employee or director is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) that are intended to hedge or offset any decrease in the market value of any equity securities granted by the company as part of compensation or held directly or indirectly by that person. One concern with hedging by directors and employees is that it may adversely affect the alignment of their interests with those of shareholders as well as cause a "disconnect" from the incentives that equity compensation awards are designed to provide.

This disclosure requirement will force companies to consider whether they want to permit hedging in light of likely adverse shareholder reaction, and may encourage companies to prohibit hedging by directors and employees entirely or only permit hedging within certain limits. The Dodd-Frank Act does not specify a rulemaking deadline, but we expect that companies will be required to comply with this new requirement for the 2011 proxy season.

- ***Actions to Take***:
  - If a company does not already have a policy regarding hedging by directors, officers and employees (usually embedded in its insider trading policy or code of ethics), it should evaluate whether or to what extent hedging should be limited. Any policy adopted or changed should be documented and communicated to the affected individuals.

C. Disclosure of Board Leadership Structures (§ 972)

Under the Dodd-Frank Act, the SEC must issue rules requiring companies to disclose in annual proxy statements why they have separated or combined the positions of chairman of the board and CEO. This mandate has already been fulfilled, however, by the SEC's proxy disclosure enhancements that took effect on February 28, 2010.[16] Under the SEC's current rules, a company soliciting proxies for the annual election of directors must describe its board leadership structure and explain why it has determined that the structure is appropriate (e.g., the reason for choosing to separate or combine the positions of chairman and CEO). Both the SEC's new rules and the Dodd-Frank Act appear responsive to the view that, by requiring companies to articulate the rationale for their leadership structures, boards with combined chairman/CEO positions may be encouraged to consider whether separating the two will foster greater board independence.

- ***Actions to Take***:
  - Boards should evaluate their leadership structures at least annually. In particular, boards of companies that have not already disclosed their policy in a proxy statement filed after February 28, 2010 and that have a combined chairman/CEO should review the justification for the combined position.

D. Whistleblower Incentives and Protections (§§ 922, 924, 929A)

The Dodd-Frank Act seeks to encourage whistleblowers by increasing significantly the SEC's whistleblower rewards program, by creating a new cause of action for employees who are retaliated against for providing information to or assisting the SEC, and by expanding the whistleblower provisions of the Sarbanes-Oxley Act.

(1) *Incentives*. The Dodd-Frank Act vastly expands the SEC's whistleblower rewards program. The SEC's existing rewards program is limited to insider trading cases, caps rewards at 10% of the funds collected as sanctions and, according to a recent report from the SEC's Office of Inspector General, has enjoyed only "minimal" success.[17] Under the new, expanded program, a whistleblower providing "original" information to the SEC that leads to a successful enforcement action resulting in monetary sanctions exceeding $1 million will be eligible for a reward of between 10% and 30% of what has been collected of the monetary sanctions imposed.[18] This would include, for example, whistleblowers who provide information leading to successful enforcement actions under the Foreign Corrupt Practices Act.

(2) *Protections*. The new whistleblower protection provisions create a cause of action for whistleblowers that allows them to go directly to federal district court, unlike the whistleblower provisions of the Sarbanes-Oxley Act which require whistleblowers to file initially with the

Department of Labor. The new cause of action: (a) applies both to those who have been retaliated against for providing information to the SEC that leads to successful proceedings brought under the federal securities laws or for otherwise assisting in such proceedings as well as to those who are retaliated against for making any disclosures protected under the Sarbanes-Oxley Act; (b) has a six-year statute of limitations (or three years from discovery of the retaliation, but not more than ten years from the event); and (c) provides for reinstatement to the whistleblower's former position if he or she has been discharged, recovery of two times back pay otherwise owed to the individual, and reimbursement for attorneys' fees and other litigation costs. Similar, but not identical, whistleblower provisions exist for matters within the jurisdiction of the Commodity Futures Trading Commission ("CFTC") and the new Bureau of Consumer Financial Protection.

(3) ***Expansions of the Sarbanes-Oxley Act.*** The Dodd-Frank Act amends the Sarbanes-Oxley Act to clarify that its whistleblower protections apply not just to employees of the public company, but also to employees of the public company's subsidiaries and other affiliates whose financial information is included in the public company's consolidated financial statements. It also amends the Sarbanes-Oxley Act: (a) to extend the statute of limitations for filing claims with the Department of Labor from 90 days to 180 days and by running the statute of limitations not only from the date of the discrimination, but also from the date on which the employee "became aware of the violation;" (b) to provide for jury trials; and (c) to make pre-dispute agreements to arbitrate Sarbanes-Oxley Act whistleblower claims unenforceable.

The SEC is required to issue final rules implementing these provisions not later than April 17, 2011.

- ***Actions to Take***:
    - Take a fresh look at the company's codes of conduct and ethics, internal whistleblower procedures and other components of the company's compliance program to assess whether they appropriately reduce the risk of violations, and encourage employees, executives and directors to report suspected violations internally at the earliest possible stage.
    - Ensure that codes and policies prohibit retaliation in line with the Dodd-Frank Act. Reinforce the prohibition on retaliation in the company's compliance training programs.

E. Board Committee Approval of Certain Swap Transactions (§§ 723, 763)

The Dodd-Frank Act requires an "appropriate committee" of any public company filing SEC reports that engages in derivatives activities to review and approve the decision to enter into covered "swap transactions" that rely on the so-called "commercial end-user" exemptions from (a) new Exchange Act requirements to clear a security-based swap or execute a security-based swap through a national securities exchange and (b) new Commodity Exchange Act requirements to clear and execute a swap through a board of trade or swap execution facility. These requirements are effective upon enactment, although as a practical matter the SEC and the CFTC first must engage in rulemaking to establish the new clearance and settlement provisions.

- ***Actions to Take***:
    - Prepare the board in general for these new obligations to review and approve covered swap transactions. This initiative should be part of a broader company effort to assess

the likely impact of the Dodd-Frank Act's derivatives requirements, including the conditions for relying on the "commercial end-user" exemptions.

- Determine which board committee should be responsible for reviewing and approving the company entering into covered swap transactions, and amend that committee's charter accordingly.
- Develop internal controls to ensure that the requisite transactions planned by management are presented to the designated committee for prior review and approval in a timely manner, and that these actions are contemporaneously documented.

F. New Governance Requirements for Financial Companies that May Influence "Best Practices" at Non-Financial Companies

The Dodd-Frank Act includes governance provisions that apply only to certain large, systemically important financial companies. Other public companies should, however, recognize that these provisions may ultimately influence what becomes best practice at public companies across-the-board.

(1) Risk Committees (§ 165)

The Dodd-Frank Act requires publicly traded nonbank financial companies supervised by the Board of Governors of the Federal Reserve System and publicly traded bank holding companies with total consolidated assets of $10 billion or more to set up risk committees responsible for the oversight of enterprise-wide risk management practices.[19] The Fed may also require publicly traded bank holding companies with total consolidated assets of less than $10 billion to establish risk committees as determined to be necessary or appropriate to promote sound risk management. The Fed is required to issue regulations mandating risk committees at these companies by July 21, 2012, to take effect no later than October 21, 2012.

Each risk committee must include such number of "independent directors" as the Fed deems appropriate, with "independence" to be defined by the Fed. Each risk committee must also have as a member at least one "risk management expert," which is defined to mean a person having experience in identifying, assessing and managing risk exposures of large, complex firms.

(2) Compensation Structures (§ 956)

The Dodd-Frank Act requires the "appropriate federal regulators,"[20] jointly, to prescribe regulations or guidelines to require "covered financial institutions" with assets of $1 billion or more[21] to disclose to their appropriate federal regulators the structures of all incentive-based compensation arrangements offered by those institutions. This disclosure -- which is expected to be kept confidential by the regulators -- must be provided to a degree sufficient to determine whether the structure provides executives, employees, directors or principal shareholders with excessive compensation, fees, or benefits or otherwise could lead to material financial losses. (Disclosure of individual compensation is not required.) The regulators must also adopt regulations or guidelines that prohibit incentive-based arrangements that the regulators determine encourage inappropriate risks or that could lead to material losses. They are required to issue these regulations or guidelines by April 21, 2011.

The appropriate federal regulators are required to ensure that any standards for compensation that are established are comparable to the standards established under the Federal Deposit Insurance Act for insured depository institutions and, in establishing such standards, to take into consideration the compensation standards described in section 39(c) of the Federal Deposit Insurance Act. These standards require consideration of whether the compensation is unreasonable or disproportionate to the services actually performed by the individual by examining, for example, the value of cash and non-cash benefits provided, the person's compensation history at the company, the company's financial condition, compensation practices at comparable companies, post-employment benefits and any breaches of duty, fraud, or other abuses.[22]

Companies that participate in the TARP are already required to limit the compensatory incentives that could lead senior executive officers to take unnecessary and excessive risks that threaten the value of the company.[23] Compensation committees of TARP participants are also required to include in the compensation committee report a statement to the effect that the compensation committee certifies that it has reviewed with senior risk officers the senior executive officer incentive compensation arrangements and has made reasonable efforts to ensure that such arrangements do not encourage these officers to take unnecessary and excessive risks that threaten the value of the company.[24]

Another helpful source of guidance for financial and non-financial companies alike was recently issued in final form by the Fed.[25] The Fed's guidance is based on the following three principles, developed through a lens of "safety and soundness," and provides that incentive compensation arrangements should:

- Provide employees with incentives that appropriately balance risk and reward;
- Be compatible with effective controls and risk management; and
- Be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

In the Fed's view, these principles apply to arrangements for all "covered employees," which includes senior executives, as well as other employees who, either individually or as part of a group, have the ability to expose the organization to "material amounts of risk." While acknowledging that arrangements can be tailored to an organization's particular business model, risk tolerance, size and complexity, the Fed's overall watchword is "balance." In the Fed's view, incentive arrangements should be balanced so that they do not give an employee incentives to increase short-term revenue or profit (especially if closely tied to the business generated by the employee himself) without regard to the full range and time horizon of risks and risk outcomes from the employee's activities. The Fed believes this requires strong controls, including the involvement in design and monitoring of highly-qualified risk management personnel (whose own incentives should be structured to preserve the independence of their perspectives) and, above all, active and effective oversight by a compensation committee reporting to the full board.

VI. On the Horizon: Possible Enhancements of the Transparency of Securities Ownership

The Dodd-Frank Act authorizes the SEC to adopt a number of rules that would enhance the transparency of securities ownership in areas that have been problematic for public companies, such as beneficial ownership reporting of notional shares underlying cash-settled total return equity swaps, the length of time before beneficial ownership must be reported and short-selling.

A. Beneficial Ownership of Security-Based Swaps (§ 766)

The Dodd-Frank Act amends Section 13 of the Exchange Act by adding new subsection (o) providing that, for purposes of both Section 13 and Section 16 of the Exchange Act

> a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap, only to the extent that the Commission, by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security.

The SEC potentially may use this provision, after consultation with other regulators, to include notional shares underlying instruments such as cash-settled total return equity swaps in the determination of beneficial ownership for purposes of Sections 13(d) and (g) and Section 16 of the Exchange Act.[26] Such swaps are commonly used today by market participants to obtain "long" or "short" economic exposure to a security without transferring voting rights. A number of activist hedge funds and others base their tactical and economic strategies in part on being able to avoid exceeding the 5% (Schedule 13D and 13G) or 10% (Form 3/Section 16) thresholds of beneficial ownership, while nonetheless obtaining an economic exposure in excess of such thresholds, through the use of such instruments. Section 16(b), in particular, can expose a greater than 10% beneficial owner to liability for profits resulting from purchases and sales within six months, even without possessing insider information.

Whether cash-settled total return equity swaps confer reportable Section 13(d) beneficial ownership was at the heart of a closely-watched proxy fight litigation decided in 2008 between CSX Corp. and two hedge funds.[27] In an amicus brief to the court, the SEC staff stated that it was generally of the view that, under current rules, cash-settled swaps do not confer beneficial ownership absent unusual circumstances. However, the district court held against the hedge funds, relying on the anti-avoidance provision of Rule 13d-3(b) to find beneficial ownership rather than directly confronting the issue of beneficial ownership through swaps generally. The case was appealed to the Second Circuit, and a decision is pending. In a separate litigation, the funds settled a claim of Section 16(b) liability by paying $11 million to CSX.

The effect of the future SEC rulemaking and/or court decisions on the scope of the beneficial ownership definition could extend beyond disclosure and hedge fund strategies. Many commercial documents, such as rights plans (or "poison pills"), stockholder agreements and change-in-control agreements (or other agreements with change-in-control provisions) contain beneficial ownership definitions, often with reference to Section 13(d) specifically. Corporate charters and bylaws sometimes include provisions pertaining to beneficial ownership, and even possibly state corporate law statutes could be implicated.[28] The possible expansion of beneficial ownership to include instruments such as cash-settled total return equity swaps could lead to triggering events not previously contemplated, unintended consequences and difficult issues of contract or other interpretation. On the other hand, such expansion could be just the thing needed to plug a loophole in an agreement or provision that was capable of being abused.

It is possible that the SEC will soon propose rules even though no deadline is prescribed by the Dodd-Frank Act.[29] The SEC staff has been looking at this issue for some time, and recommending proposed changes to Regulation 13D-G to modernize beneficial ownership reporting requirements is on its regulatory agenda for September 2010. But it is also possible that this will be pushed back in light of all the other mandated rulemaking brought about by the Act.

- ***Actions to Take***:
  - Users of equity swaps should re-evaluate their strategies in light of potential rule changes or prepare for compliance, with particular vigilance aimed at avoiding inadvertent triggers (e.g., poison pill threshold or 10% Section 16 threshold).
  - Public companies, investors and others should begin identifying agreements or provisions that are likely to be affected and evaluating potential issues.
  - Institutional investment managers should note that eventual SEC rulemaking could require them to consider security-based swaps for purposes of making reports under Section 13(f) of the Exchange Act.

B. Deadlines for Initial Reports of Beneficial Ownership (§ 929R)

Currently, an initial report on Schedule 13D under Section 13(d) of the Exchange Act and an initial report on Form 3 under Section 16(a) of the Exchange Act must be publicly filed with the SEC within 10 calendar days of crossing the initial beneficial ownership reporting threshold (5% and 10%, respectively). A 10-day window, particularly for Schedule 13D filings, has been criticized for decades as being too long -- allowing "stealth" accumulations of large amounts of voting stock (sometimes well in excess of the specified thresholds) prior to the filing deadlines. The Dodd-Frank Act authorizes the SEC to shorten this 10-day window. Given that the agency has long sought this authority, we expect that "closing the window" by some means will be part of the SEC's anticipated rulemaking proposal to modernize beneficial ownership reporting. A change from the current status quo will likely adversely affect some M&A and takeover strategies.

- ***Actions to Take***:
  - Acquirers should evaluate the impact of a potentially shortened reporting timeframe on accumulation and takeover strategies.

C. Disclosure of Short Sales by Institutional Investment Managers (§ 929X)

The Dodd-Frank Act amends Section 13(f) of the Exchange Act to require the SEC to adopt rules imposing a new duty on institutional investment managers filing Form 13F reports to disclose their short positions -- on at least a monthly basis – "in connection with" each class of equity securities of each portfolio company. This provision also amends Section 9 of the Exchange Act to make it unlawful for any person to engage in a manipulative short sale of any security, while the SEC is empowered to issue rules "as are necessary or appropriate to ensure that the appropriate enforcement options and remedies are available for violations of this subsection in the public interest or for the protection of investors."

VII. Investor-Related Initiatives at the SEC

The Dodd-Frank Act establishes two new bodies intended to facilitate investor input into SEC decision-making.

A. Investor Advisory Committee (§ 911)

The Dodd-Frank Act establishes a new, permanent Investor Advisory Committee to consult with and advise the SEC on matters such as making recommendations to Congress for legislative changes on the regulation of securities products, trading strategies and fee structures, the effectiveness of disclosures, and other investor protection initiatives. As such, the Committee could well replace the existing federal advisory committee established by the SEC in June 2009 to provide for direct SEC-investor dialogue.

The new Committee will consist of the head of the newly-created Office of the Investor Advocate (described below), a representative of senior citizens, a representative of state securities commissions, and 10 to 20 representatives of individual and institutional investors appointed by the SEC. The Committee will not have any designated public company representation, and its Chairman and Vice Chairman may not be employed by any public company. The Act requires the SEC to disclose promptly its assessment of any Committee findings or recommendations and the actions it intends to take to address them.

B. Office of the Investor Advocate (§ 915)

The Dodd-Frank Act creates an Office of the Investor Advocate within the SEC but with independent reporting obligations to Congress. The head of the Office will be appointed by the SEC Chairman and has a mandate to: (a) assist retail investors in resolving significant problems such investors may have with the SEC or with self-regulatory organizations; (b) identify areas in which investors would benefit from changes to the SEC regulations and SRO rules; (c) identify problems that investors have with financial service providers and investment products; (d) analyze the potential impact on investors of proposed SEC and SRO rules; and (e) propose changes in such rules and regulations that may be appropriate to promote investor interests.

VIII. SEC Review of the U.S. Proxy Voting System

As if the SEC did not have enough on its plate with the numerous rulemaking projects assigned by Congress under the Dodd-Frank Act, the agency has undertaken another, potentially enormous project -- a comprehensive review of the complex network of relationships and responsibilities that comprise the nation's proxy voting system. The SEC took a major, if preliminary, step down this long road on July 14, 2010, voting unanimously to issue a "concept" release that contains a detailed description of the current state of play and raises myriad issues for public comment on what has collectively been termed "proxy plumbing:" the mechanics of how proxy materials are distributed to shareholders, how shareholders vote, and how those votes are processed.[30]

In the release, which makes no immediately actionable proposals, the SEC focuses on three broad topic areas that have been the subject of increasing concern in recent years, outlining both the perceived problems and potential regulatory responses. These areas are: (a) the accuracy, transparency and efficiency of the proxy voting process, with a particular emphasis on the realities of present-day forms of indirect stock ownership through broker-dealer and bank intermediaries, often referred to as owning stock in "street-name;" (b) proxy-related communications with shareholders by issuers and a bewildering variety of third parties; and (c) the potential "disconnect" between voting power and economic interest attendant to stock ownership caused by such factors as the rise of intermediation and the proliferation of equity-based hedging activities.

The stated goals of the SEC's review are to promote greater efficiency and transparency in the system and to enhance the accuracy and integrity of the shareholder vote. Toward this end, the SEC is seeking information and comments from all interested parties: companies, individual and institutional investors, broker-dealer and bank intermediaries and the proxy service providers serving as their agents, transfer agents, proxy advisory firms, proxy solicitors, and vote tabulators. Submissions are due within 90 days after publication of the release in the Federal Register, which has not yet occurred. Here is more on the three main areas of the review:

(1) ***Accuracy, Transparency and Efficiency***. The SEC is examining such key issues as whether "over-voting" and "under-voting" by broker-dealer intermediaries occur to any measurable extent, whether companies and beneficial owners of shares who hold stock through intermediaries each have an effective means of confirming the timely receipt and recording of voting instructions, whether the securities lending practices of pension funds and other institutional shareholders have led to voting imbalances, and whether the fees now charged to companies by intermediaries (and their agents) for distributing proxy materials to street-name holders are reasonable. As discussed further below, the Dodd-Frank Act requires that, within two years, the SEC adopt rules addressing the current lack of transparency in the share-lending market.

(2) ***Issuer Communications with Shareholders and Shareholder Voting Participation***. The SEC is exploring whether companies should be permitted under the proxy rules to communicate directly with street-name owners of their stock, and whether current mechanisms for allowing those beneficial owners to object to such direct communications appropriately balance such interests against shareholders' countervailing interest in maintaining financial privacy, and broker-dealers' interest in protecting the confidentiality of client information. In addition, the SEC acknowledges low levels of voting participation by retail shareholders and solicits comment on an array of possible solutions, including investor education and more creative uses of the Internet for communication purposes.

(3) ***Relationship of Voting Power and Economic Interest.*** The SEC is concerned about the potentially negative implications of the separation of voting power and economic interests in corporate stock attributable to increased hedging activities, share lending practices and the role of proxy advisory firms that have no economic stake in individual companies' shares yet make highly influential voting recommendations and, in some cases, exercise delegated voting authority to vote institutional clients' shares in favor of their own recommendations. As reflected in the release, the SEC has been evaluating for some time whether certain forms of hedging activity that permit the accumulation of voting power in stock without any accompanying economic exposure (so-called "empty voting") should be subject to the current beneficial ownership reporting rules outlined in Sections 13(d) and (g) of the Exchange Act, and Regulation 13D-G thereunder (as well as the Section 16(a) beneficial ownership reporting obligation derived from the foregoing).[31] The core regulatory concepts of voting power under the proxy rules and beneficial ownership reporting are inextricably linked through the SEC's disjunctive definition of "beneficial ownership," which rests on the possession of either the power to vote (or to direct the vote) or the power to dispose (or to direct the disposition) of a single share of voting stock.[32] In this connection, the SEC observed in a footnote that the staff "is working on the separate but related project of reviewing disclosure requirements relating to holdings of financial instruments, including short sale positions and derivatives positions."[33]

Certain provisions of the Dodd-Frank Act ultimately may determine the direction of SEC rulemaking in both the proxy and beneficial ownership reporting areas. Section 417 of the Act requires the SEC to report within one year on short sales. This conceivably could lead to consideration of suggestions to expand the Regulation 13D-G definition of beneficial ownership to capture large net short positions that now are not subject to disclosure. Last but not least, Section 984 of the Act requires the SEC to act within two years to implement rules "designed to increase the transparency of information … with regard to the loan or borrowing of securities." A vibrant share-lending market is essential to the success of various short-selling strategies involving illiquid equity securities.

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If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of the Firm's Public Company Advisory Group:

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Appendix A

Summary of Further Required Implementing Action, Effective Dates and Applicability of the Governance and Disclosure Provisions of the Dodd-Frank Act

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
Part II. Impact on Shareholder Meetings			
"Proxy access" -- SEC expressly authorized to adopt rules and procedures relating to the inclusion of shareholder board nominees in a company's proxy solicitation materials (§ 971)	SEC may, but is not required to, issue rules providing access.	Expect the SEC to move quickly towards final rulemaking on its pending access proposal in order to fulfill the Chairman's commitment that proxy access be in effect for the 2011 proxy season.	All public companies, subject to any SEC exemptions. In determining whether to make an exemption, the SEC must take into account whether the requirement disproportionately burdens small issuers.
Mandatory non-binding advisory votes (annually, biennially or triennially as determined by shareholders at least every 6 years) on executive compensation and, when M&A transactions are to be voted on, on certain "golden parachute" compensation to named executive officers relating to M&A transactions, and related disclosure (§ 951)	Vote requirements are self-executing, but we expect SEC rulemaking.	Resolutions relating to say-on-pay and the frequency of say-on-on-pay votes to be included in proxy statements for annual shareholder meetings (and other meetings at which executive compensation disclosure is required to be included in the proxy statement) held on or after January 22, 2011 (six months after enactment). Resolutions relating to golden parachute provisions are required to be voted on at meetings held on or after January 22, 2011 (six months after enactment).	Say-on-pay requirements apply to all public companies, subject to any SEC exemptions. Golden parachute requirements apply to all public companies seeking shareholder approval of an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the company's assets, subject to any SEC exemptions. In determining whether to make an exemption, the SEC must take into account whether the requirement disproportionately burdens small issuers.
Disclosure at least annually of votes by certain institutional investment managers on say-on-pay, say-on-pay frequency and golden parachute resolutions (§ 951)	Requirement to disclose votes by certain institutional investment managers is self-executing, but will require SEC rulemaking.	Not specified.	Institutional investment managers subject to Section 13(f) of the Exchange Act.
Elimination of broker discretionary voting on director elections, executive compensation and any other "significant matters" as determined by the SEC (§ 957)	SEC to determine what constitutes any other "significant matter" and national securities exchanges to issue related listing rules.	Not specified, but we expect that rulemaking will occur quickly.	Member brokers of national securities exchanges; with respect to shares of all companies, whether or not listed.

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
Part III. New Executive Compensation Disclosures			
Proxy statement disclosure of the relationship between executive compensation actually paid and the company's financial performance (§ 953)	SEC rulemaking required.	Not specified.	All public companies.
Proxy statement disclosure of (a) median employee compensation (except the CEO), (b) total CEO compensation and (c) the ratio of (a) to (b) (§ 953)	SEC rulemaking required.	Anticipated to be in effect for the 2012 proxy season.	All public companies.
Part IV. Independence of the Compensation Committee and its Advisers			
Heightened independence requirements for compensation committee members, considering factors such as receipt of consulting, advisory or other compensatory fees and "affiliate" status (§ 952)	SEC rulemaking required and national securities exchanges to issue related listing rules.	Effective national securities exchange rulemaking in accordance with SEC rules required by July 16, 2011 (360 days after enactment).	All listed companies, other than controlled companies, limited partnerships, companies in bankruptcy proceedings, open-ended registered management investment companies and foreign private issuers that provide annual disclosure to shareholders of reasons why they do not have an independent compensation committee. National securities exchanges may exempt (i) a particular relationship, taking into consideration the size of an issuer and any other relevant factors, and/or (ii) a category of issuers, taking into account the potential impact on smaller issuers.
Direct authority of compensation committees to appoint, compensate and provide oversight of the work of consultants, independent legal counsel and other advisers to the committee (§952)	SEC rulemaking required and national securities exchanges to issue related listing rules.	Effective national securities exchange rulemaking in accordance with SEC rules required by July 16, 2011 (360 days after enactment).	All listed companies, other than controlled companies. National securities exchanges may exempt a category of issuers, taking into account the potential impact on smaller issuers.

Provision	***Further Regulatory Action?***	***Effective Date***	***Applicability***
Mandatory consideration of factors bearing on independence when selecting compensation consultants, legal counsel and other compensation committee advisers	SEC required to identify factors that are required to be taken into account in selecting a compensation consultant or other adviser which may affect the independence of a compensation consultant or other adviser to a compensation committee. National securities exchanges to issue related listing rules.	Effective national securities exchange rulemaking in accordance with SEC rules required by July 16, 2011 (360 days after enactment).	All listed companies, other than controlled companies. National securities exchanges may exempt a category of issuers, taking into account the potential impact on smaller issuers.
Proxy statement disclosure of whether the compensation committee retained a compensation consultant, whether the work performed by such consultant raised a conflict of interest, the nature of such conflict and how it is being addressed (§952)	SEC rulemaking required.	Proxy disclosure required to be included in proxy statements for annual shareholder meetings occurring on or after July 21, 2011 (one year after enactment).	
Part V. Other Key Governance Provisions			
Development, implementation and disclosure of a "clawback" policy on incentive compensation that requires the company to recover from current and former executive officers any excess incentive compensation based on erroneous data during 3 year period preceding any restatement of financial statements due to material noncompliance with financial reporting requirements (§ 954)	SEC rulemaking required and national securities exchanges to issue related listing rules.	Not specified.	All listed companies.
Proxy statement disclosure of whether employees and directors are permitted to purchase financial instruments to hedge or offset any decrease in market value of shares granted by the company as compensation or held by that person (§ 955)	SEC rulemaking required.	Not specified.	All public companies.
Proxy statement disclosure of reasons for separation of Chairman and CEO (§ 972)	SEC rulemaking is complete.	Existing SEC rules have been effective since February 28, 2010.	Every company subject to SEC periodic reporting requirements.
Whistleblower incentives and protections (§§ 922, 924, 929A)	SEC is required to issue final rules implementing whistleblower incentive provisions. Whistleblower protection provisions are self-executing.	Final rules relating to whistleblower incentives to be issued not later than April 17, 2011 (270 days after enactment). Provisions relating to whistleblower	All public companies.

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
		protections effective upon enactment.	
Board committee approval of certain swap transactions (§§ 723, 763)	Self-executing. SEC and Commodity Futures Trading Commission to engage in rulemaking to establish new clearance and settlement provisions.	Upon enactment.	Public companies engaging in derivatives activities.
Mandatory risk committees at publicly traded "nonbank financial companies supervised by the Federal Reserve Board of Governors" and publicly traded bank holding companies with total consolidated assets of $10 billion or more (§ 165)	Federal Reserve Board of Governors required to issue regulations.	Final rules to be issued by the Federal Reserve Board of Governors by July 21, 2012 (2 years after enactment), to take effect not later than October 21, 2012 (1 year and 15 months after enactment). Risk committees to be established at nonbank financial companies within one year of receipt of a notice of final determination from the Financial Stability Oversight Council that a nonbank financial company shall be supervised by the Fed. Risk committees to be established at publicly traded bank holding companies with total consolidated assets of $10 billion or more in accordance with Fed regulations.	"Nonbank financial companies supervised by the Federal Reserve Board of Governors," which is defined to include companies that are substantially engaged in financial activities in the U.S. where it has been determined by the Financial Stability Oversight Council that material financial distress at the company would pose a threat to the financial stability of the U.S. (other than bank holding companies or their subsidiaries). Publicly traded bank holding companies with total consolidated assets of $10 billion or more, although the Fed may require publicly traded bank holding companies with total consolidated assets of less than $10 billion to establish risk committees as determined necessary or appropriate by the Fed to promote sound risk management.

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
Disclosure by "covered financial institutions" to appropriate federal regulators of the structures of all incentive-based compensation arrangements to enable determination of whether structures provide executives, employees, directors or principal shareholders with excessive compensation, fees or benefits, or otherwise could lead to material financial losses Prohibition on "covered financial institutions" adopting incentive-based arrangements that appropriate federal regulators determine encourage inappropriate risks by providing executives, employees, directors or principal shareholders with excessive compensation, fees or benefits or that could lead to material financial losses (§ 956)	Appropriate federal regulators, jointly, are required to prescribe regulations or guidelines.	By April 21, 2011 (nine months after enactment).	"Covered financial institutions" -- depository institutions, depository institution holding companies, registered broker-dealers, credit unions, investment advisors, Fannie Mae, Freddie Mac and any other financial institutions that the appropriate federal regulators jointly by rule determine should be treated as a covered financial institution. Covered financial institutions with assets of less than $1 billion are exempt.
Part VI. On the Horizon: Possible Enhancements of the Transparency of Securities Ownership			
Expanded reporting of beneficial ownership of covered equity securities (§ 766)	SEC may, but is not required to, issue rules.	Upon enactment.	All public companies subject to Section 13 and Section 16 of the Exchange Act.
SEC authority to shorten timing of filing beneficial ownership and short-swing profit and Section 13 reports (§ 929R)	SEC may, but is not required to, issue rules shortening timing of filings.	Upon enactment.	All public companies subject to Section 13 and Section 16 of the Exchange Act.
Short sale disclosure by institutional investment managers (§ 929X)	SEC rulemaking required.	Not specified.	Institutional investment managers subject to Section 13(f) of the Exchange Act.
Part VII. Investor-Related Initiatives at the SEC			
Investor Advisory Committee (§ 911)	SEC to establish bodies.	Upon enactment.	SEC organizational structure.
Office of Investor Advocate (§ 915)	SEC to establish bodies.	Upon enactment.	SEC organizational structure.

Appendix B

Assessing Shareholder Relations: Questions to Ask

A board should consider the following questions when assessing the company's approach to shareholder relations:[34]

Culture and Attitude

- Are we cultivating the appropriate culture and attitude for healthy and productive shareholder engagement?
- Do the senior management team and the board understand the new reality of pending changes and heightened pressures?

Governance Structures

- Have we undertaken an assessment of our board composition and our governance structures and practices in light of the emerging changes in governance regulation and do we know what we may need to change should it be enacted?
- Are there any changes that make sense to make now to get out ahead of the curve?

Key Shareholders

- Do we know who our top 25 to 30 shareholders are and what governance issues they are most interested in and concerned about? Of these top shareholders:
    - Do we know how they tend to vote and do we know which proxy advisory services they rely on?
    - Do we know what guidelines they use in voting on shareholder matters?
    - Do we know what activist campaigns they have engaged in?
- Outside of our largest shareholders, do we have any shareholders who regularly bring shareholder proposals at our company or at other companies or otherwise engage in active shareholder strategies? (For example, consider ownership by public and union pension funds.)

Shareholder Outreach

- What kind of shareholder outreach does the company engage in?
- Do we have a significant number of small shareholders who do not participate in voting, and if so, what can we do to encourage them to vote?
- Is the company devoting appropriate resources to shareholder communication and engagement issues, including adequate staff and advisors?
- What is the role of investor relations and our corporate secretary/chief governance officer in these efforts, and how do they interact on these issues? Does the company need more focused outreach and interaction with both traditional analysts and their governance-focused colleagues?
- Do we have a creative, credible and capable team in place?

Governance Community Involvement

- Are we linked in to the range of groups who influence thinking in the governance area, from the Council of Institutional Investors to the Society of Corporate Secretaries and Governance Professionals to the Business Roundtable and National Association of Corporate Directors?

- Is the corporate secretary/chief governance officer or other member of the management team engaged in local chapters of these groups where possible and, in particular, working at building informal relationships with thought leaders in the shareholder community?

Laws and Regulations
- Are we prepared to involve independent directors in shareholder communications on key issues when appropriate (for example, involving the lead director and the chairs of the compensation and governance committees in meetings with key shareholders based on the particular issue)?
- Have we adopted a clear policy about shareholder and other communications by individual directors to address securities law and fiduciary duty concerns about the disclosure of confidential information? In addition:
    - Have we reminded individual directors that they should not engage in ad hoc communications about the company with shareholders, the media or others?
    - Are the board leader and counsel involved in the coordination of all these communications?

Proxy Advisors
- Do we regularly review information available from proxy advisors concerning their views, including any policy guidance that informs their vote recommendations?
- Where our practices deviate from the views promoted by proxy advisors, have we articulated our rationale for our practice and have we communicated to shareholders why we believe it is the better approach for our company?
- Has the corporate secretary/chief governance officer or other appropriate member of management cultivated a positive relationship with proxy advisors?

Information to Shareholders
- Do we view the company’s public filings as an opportunity to communicate with shareholders or merely as a regulatory compliance burden?
- Are we doing all that we can to provide transparent, relevant information to shareholders and avoid boilerplate?
- In instances where board decisions (whether related to company strategy or governance matters) diverge from the known priorities of a significant segment of the company’s shareholders, are we doing all we can to explain the rationale for the decisions, particularly where the long-term benefits associated with certain decisions may not be immediately clear?
- Have we considered what other information shareholders may need to understand the situation the way the board views it?
- What else should we be doing to address the challenges of the “new normal” in governance?

ENDNOTES

[1] The House of Representatives passed the Dodd-Frank Act on June 30, 2010 and the Senate passed the Act on July 16, 2010. The Dodd-Frank Act reconciled provisions in The Restoring American Financial Stability Act of 2010, which was introduced by Senator Christopher J. Dodd (D-CT), Chairman of the Senate Banking Committee, in March 2010 and passed by the Senate on May 20, 2010, and The Wall Street Reform and Consumer Protection Act of 2009 introduced by Representative Barney Frank (D-MA), Chairman of the House Financial Services Committee, and passed by the House on December 11, 2009. For a detailed discussion of the bills introduced by Senator Dodd and Congressman Frank, see our Weil Briefings "Congressional Watch: Senate Passes Financial Stability Bill Calling for SEC Proxy Access Authority and Other Governance and Executive Compensation Reforms" (May 24, 2010), available at http://www.weil.com/news/pubdetail.aspx?pub=9812, and "Congressional Watch: House Passes Sweeping Wall Street Reform Bill Including Governance Provisions on 'Say-on-Pay,' Compensation Committee Independence and S.E.C. Proxy Access Authority" (December 14, 2009), available at http://www.weil.com/news/pubdetail.aspx?pub=9670.

[2] Management-sponsored say-on-pay proposals failed at Motorola (receiving the support of 38% of votes cast), Occidental Petroleum (39%) and KeyCorp (45%).

[3] The highest number of favorable votes this year were 68% of votes cast at Ameron International and 48% votes in favor at Honeywell International.

[4] Data sourced from RiskMetrics Group's Governance Analytics service.

[5] SEC, CF Staff Legal Bulletin No. 14E, *Shareholder Proposals* (October 27, 2009), available at http://www.sec.gov/interps/legal/cfslb14e.htm. Several shareholder proposals relating to succession were voted on in 2010, with relatively high levels of support at Bank of America (40.1%) and Verizon Communications (32.4%), and lower support at Comcast (14.5%). A shareholder proposal seeking a report on board oversight of risk management at ConocoPhillips received 5% support in 2010.

[6] Note that the SEC staff recently clarified that Regulation FD does not prevent directors from speaking privately with a shareholder or groups of shareholders, although it urges companies to consider implementing policies and procedures to help avoid Regulation FD violations, such as pre-clearing discussion topics with the shareholder or having company counsel participate in the meeting. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 101.11 (last updated June 4, 2010), available at http://www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm.

[7] Data sourced from SharkRepellent, as of July 15, 2010.

[8] *See* SEC Proposing Release, *Facilitating Shareholder Director Nominations* (Release No. 33-9046, June 10, 2009), available at: http://www.sec.gov/rules/proposed/2009/33-9046.pdf. For a detailed discussion of this release and the history of proxy access, see our Weil Briefing "SEC Proposes New Rule Mandating Proxy Access" (June 23, 2009), available at http://www.weil.com/news/pubdetail.aspx?pub=9506.

[9] SEC Chairman Mary L. Schapiro, Address to The Business Roundtable (June 8, 2010), available at http://www.sec.gov/news/speech/2010/spch060810mls.htm.

[10] An example of a TARP recipient's say-on-pay resolution: "Resolved, that the stockholders approve the compensation of executives, as disclosed 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."

[11] Webcast, "Inside Track with Broc: Peggy Foran and Ed Ballo on Results of Innovative Voting Campaign," *The Corporate Counsel* (June 1, 2010).

[12] SEC Chairman Mary L. Schapiro, Testimony Before the United States House of Representatives Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises (July 20, 2010), webcast available at http://financialservices.house.gov/Hearings/hearingDetails.aspx?NewsID=1326.

[13] *See* Section 301 of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"); Exchange Act Rule 10A-3; NYSE Listed Company Manual, Section 303A.07; Nasdaq Marketplace Rules, Rule 5605(c).

[14] *See* Section 301 of the Sarbanes-Oxley Act; Section 10A(m)(1)(B) of the Exchange Act; Exchange Act Rule 10A-3(a)(3); NYSE Listed Company Manual, Section 303A.06; Nasdaq Marketplace Rules, Rule 5605(c)(4).

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[15] The SEC did not provide guidance on Section 304 of the Sarbanes-Oxley Act.

[16] *See* SEC Final Release, *Proxy Disclosure Enhancements* (Release No. 33-9089, December 16, 2009), available at http://www.sec.gov/rules/final/2009/33-9089.pdf. For a detailed discussion of this disclosure requirement, see our Weil Briefing "Challenges of the 2010 10-K and Proxy Season" (December 30, 2009), available at http://www.weil.com/news/pubdetail.aspx?pub=9688.

[17] SEC Office of Inspector General, *Assessment of the SEC's Bounty Program* (March 29, 2010), available at http://www.sec-oig.gov/Reports/AuditsInspections/2010/474.pdf.

[18] The SEC has discretion to determine the amount of any award made to a whistleblower, taking into consideration: (1) the significance of the information provided by the whistleblower to the success of the action; (2) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower; (3) the SEC's programmatic interest in deterring securities law violations by making whistleblower awards; and (4) such additional relevant factors as the SEC may establish by rule or regulation. The SEC may not, however, take into account the balance of funds left in the SEC's Investor Protection Fund from which such awards are to be paid.

[19] "Nonbank financial company supervised by the Federal Reserve Board of Governors" is defined to mean a company that is substantially engaged in financial activities in the U.S. where it has been determined by the Financial Stability Oversight Council that material financial distress at the company would pose a threat to the financial stability of the U.S. (other than bank holding companies or their subsidiaries).

[20] "Appropriate federal regulator" is defined to include the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the SEC and the Federal Housing Finance Agency.

[21] "Covered financial institution" is defined to include a depository institution, depository institution holding company, broker-dealer registered under section 15 of the Exchange Act, credit union, investment adviser, Fannie Mae, Freddie Mac and any other financial institution that the appropriate federal regulators jointly by rule determine should be treated as a covered financial institution.

[22] The standards listed in Section 39(c) of the Federal Deposit Insurance Act: (i) prohibit as an unsafe and unsound practice any employment contract, compensation or benefit agreement, fee arrangement, perquisite, stock option plan, postemployment benefit, or other compensatory arrangement that: (a) would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees or benefits; or (b) could lead to material financial loss to the institution; (ii) specify when compensation, fees, or benefits referred to in paragraph (i) are excessive, which shall require the agency to determine whether the amounts are unreasonable or disproportionate to the services actually performed by the individual by considering: (a) the combined value of all cash and noncash benefits provided to the individual; (b) the compensation history of the individual and other individuals with comparable expertise at the institution; (c) the financial condition of the institution; (d) comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets; (e) for postemployment benefits, the projected total cost and benefit to the institution; (f) any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution; and (g) other factors that the agency determines to be relevant; and (iii) such other standards relating to compensation, fees, and benefits as the agency determines to be appropriate.

[23] *See* Section 111(b)(3) of the Emergency Economic Stabilization Act of 2008, as amended; *see also* U.S. Department of the Treasury regulations and guidance, available at http://www.treas.gov/initiatives/eesa/executivecompensation.shtml.

[24] 31 C.F.R. §§30.3 & 30.5.

[25] *See* Final Guidance on Sound Incentive Compensation Policies (June 21, 2010), available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100621a1.pdf.

[26] Provided that a person was otherwise subject to Section 16, such person needed to report transactions in, and could be liable for short-swing profits on, security-based swaps, even prior to the enactment of the Dodd-Frank Act. The reference to Section 16 in the Act's amendment to Section 13(d) likely was made to clarify that the Act's change to Section 13(d) would also carry over for purposes of determining 10% beneficial ownership under Section 16 (i.e., swaps could be counted in the calculation).

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[27] *See* CSX Corp. v. The Children's Investment Fund Management (UK) LLP, *et al.*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008).

[28] However, some existing agreements might not be effected. For example, some include a beneficial ownership definition by reference to Section 13(d) and the rules thereunder *as in effect on the date of the agreement.* And some may already incorporate beneficial ownership of derivatives, including those that are only cash-settled.

[29] *See* Section 774 of the Dodd-Frank Act regarding effective date of this provision.

[30] SEC, *Concept Release on the U.S. Proxy System* (Release No. 34-62495, July 14, 2010), available at http://www.sec.gov/rules/concept/2010/34-62495.pdf (hereinafter, the "Concept Release").

[31] *Id.* at 141-142 (discussing a merger arbitrage technique used by a registered investment adviser in connection with a controversial merger, in which the adviser, which had an equity position in the target company, acquired nearly 10% of the voting rights of the prospective acquirer "for the exclusive purpose of voting the shares in a merger and influencing the outcome of the vote" without assuming any economic risk in those shares; the SEC noted its concern about the de-coupling of voting power and economic risk in equity securities associated with some hedging techniques.).

[32] Exchange Act Rule 13d-3.

[33] Concept Release at 145, n328.

[34] *See* Holly J. Gregory, "Financial Reforms: Influencing a 'New Normal' in Corporate Governance," *Practical Law The Journal* (June 2010).