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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 on July 21, 2010, 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 Act 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 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 Act, important aspects of which require rulemaking by the SEC and national securities exchanges, include:

- express authority for the SEC 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

This Briefing is intended to give chief legal officers, corporate secretaries and others who work with the board a head start in planning to meet the challenges stemming from the Act for the upcoming proxy season. 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 Act, of enhancing the accuracy and integrity of the shareholder voting process.

Update on SEC Rulemaking Under the Act – see Appendix A

- On August 25, 2010, the SEC adopted rules implementing proxy access that will apply to a company's 2011 proxy season unless it either mailed the proxy statement for its 2010 annual meeting prior to March 13, 2010 or is a "smaller reporting company."
- On September 9 and 24, 2010, the SEC approved NYSE and Nasdaq rule changes barring discretionary voting by brokers on all executive compensation matters, including say-on-pay.

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

The new requirements of the 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:** The SEC promptly exercised its authority under the Act to establish a right to proxy access. Eligible shareholders and groups may include in company proxy materials their nominees for up to 25% of the board (with a minimum of one). The principal eligibility standards are continuous ownership, for at least 3 years, of at least 3% of the total voting power of company securities entitled to vote in the election of directors. The new rules will apply to access nominations for the 2011 proxy season unless a company either mailed the proxy statement for its 2010 annual meeting before March 13, 2010 or is a smaller reporting company (i.e., has a market capitalization below $75 million) for which access is deferred for three years. For most companies that hold their annual meeting in late April or early May, access nominations will first be due in late November or early December. The rules have come under court challenge and a stay of effectiveness is being sought.
- **"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 21, 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]
  - Although the new disclosure rules on these subjects will probably not yet be in place, 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 could influence say-on-pay votes.
- **No Broker Discretionary Voting on Executive Compensation:** Adding to the bar on discretionary voting for directors, NYSE and Nasdaq rule changes now bar brokers from voting customer shares without customer instructions on say-on-pay proposals or any other executive compensation matter. We expect bank custodians to follow this practice.
- **Shareholder Proposals on Governance:** Expect access and say-on-pay votes to play out in the context of continuing shareholder proposals on governance issues. Capitalizing on newly amended SEC Rule 14a-8(i)(8), one potentially significant set of proposals this year may seek to expand proxy access by, among other things, easing the 3% and/or 3 year eligibility requirements. Other proposals may build on the experience of the 2010 season, when 35 proposals to separate the positions of Chairman and CEO received an average of 28% support;[3] 31 to require majority voting in uncontested director elections averaged 57% support; 43 to declassify the board averaged 62% support; and 43 to establish a shareholder right to call a special meeting averaged 43% support.[4] Also expect an increase in 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 directors are up to speed on the new requirements and understand the heightened pressures. Adjust board and committee calendars to ensure sufficient time to tackle the new requirements.
- **Help Shape the Rulemaking Needed to Implement the 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 and Communications:** 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 and communications. (For suggested questions, see Appendix C.)
  - Ensure that information systems and communications programs enable management and the board to monitor changes in the nature or activism of the company's shareholder base and to identify and respond readily to shareholder concerns. Review and consider enlarging the group of shareholders with whom you regularly engage.
  - The influence of proxy advisors is likely to continue to grow with the advent of say-on-pay and proxy access, and advisors have been very receptive to "short-slates" of directors nominated by activists. Be well-versed on institutional investor and proxy advisor positions on "hot button" issues – and prepared to articulate and defend 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, senior management and investor relations personnel so that messages are coordinated, boardroom confidentiality is protected and Regulation FD is complied with.[6]
  - Consider extra efforts to encourage retail shareholders to vote.
  - Review last year's proxy materials and proxy advisor analysis to see if this year's materials can be more effective in communicating positive steps the company and board have taken.
- **Review Advance Notice Bylaws, Director Qualifications and Majority Voting Provisions:** Advance notice bylaws should be reviewed in light of the SEC's statement that the access rule supersedes provisions of governing documents that "prohibit inclusion of shareholder director nominees in company proxy materials." Consider amending advance notice bylaws to add a provision that makes any timing or other provisions of the bylaw that would be pre-empted by the access rule expressly inapplicable to access nominations. Director qualification requirements should also be considered. There may in practice be objective, minimum requirements for board membership that have not been stated in the bylaws as director qualifications. The board may now wish to formalize these in the bylaws and to consider whether any additional qualifications would be appropriate in light of the fact that access nominees could be seated without being vetted by the nominating and governance committee of the board. Finally, review majority voting provisions to ensure that the customary exception for election contexts is broad enough to encompass access nominations.

- **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 or misalignment between "pay" and "performance" and how the program matches up to proxy advisor guidelines. 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 and the rationale for the recommendation (e.g., a multi-year timeframe for measuring the attainment of incentives).
  - Plan for new "clawback" requirements when making awards now.
- **Review Compensation Committee Membership and Advisers:** To determine whether any changes are likely to be needed to pass forthcoming independence tests, assess the current compensation committee under the audit committee independence tests. For advisors, apply the general conflict-of-interest disclosure criteria prescribed by the Act for consultants.

When to Expect More From the SEC

The SEC has posted its planned timetable for implementing the Dodd-Frank Act. Below are actions relevant to the proxy season. (Key: P = proposal of rule; A = adoption of rule)

	October – December 2010	January – March 2011	April – July 2011
Whistleblower incentives and protection program (§922)	P	A	
Say-on-pay, say-when-on-pay and golden parachute votes (§951)	P	A	
Compensation vote disclosure by investment advisors (§951)	P	A	
Exchange listing standards relating to compensation committees and advisers; consultant conflict disclosure (§952)	P		A
Pay-for-performance, pay ratios and hedging disclosure (§§953 and 955)			P
Clawbacks (§954)			P
Defining "other significant matters" for which broker discretionary voting will be barred (§957)			P

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 Act to State Law and 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 its proponents hope will, in combination, give investors a greater voice in board composition and executive compensation.

A. Proxy Access Rulemaking Authority (§ 971) – and New Rules

Seeking to resolve a long-running and ardent debate, Congress, through the Act, gave 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. The Act left all terms and conditions of access to SEC rulemaking subject to the agency's determination that they are in the interests of shareholders and for the protection of investors. The Act also gave the SEC express discretion to consider exemptions based on factors such as the potential for disproportionate burdens on small companies.

Having received hundreds of comments on its June 2009 proxy access proposal,[8] the SEC moved quickly to fulfill its Chairman's commitment to put proxy access in place for the 2011 session.[9] Under new Exchange Act Rule 14a-11, adopted on August 25, 2010, a company will be required to include on the company's proxy card and in its proxy statement – at its own expense – director nominees selected by a shareholder or a group of shareholders that meet certain eligibility standards: continuous ownership for at least 3 years of at least 3% of the total voting power of the securities entitled to vote for the election of directors. Proxy access will be available for nominees for 25% of the board (or the greatest whole number below 25%, with a minimum of one). Shareholders may not use access for the purpose of "changing control of the company."

The SEC also adopted a series of related amendments to the proxy rules. Of particular note, amended Rule 14a-8(i)(8) will eliminate a company's previously broad ability to omit from inclusion in its proxy statement shareholder proposals that "relate to an election." This will require companies to include proposals to make the requirements for access more liberal (but not more stringent) than those established in Rule 14a-11. Early indications are that many such proposals may be made in the 2011 proxy season.

The new rules will be effective on November 15, 2010 and will apply to the 2011 proxy season unless a company either mailed its 2010 proxy statement before March 13, 2010 or is a "smaller reporting company." ***A summary of the new rules is provided in Appendix A.***

The new rules – other than the amendment to Rule 14a-8 – have come under court challenge, as the Chamber of Commerce of the U.S. and The Business Roundtable have sought to have the rules declared invalid as violative of the Administrative Procedure Act and on other grounds. A stay of effectiveness is being sought.

- **Actions to Take**
  - The board and particularly its nominating and governance committee should review the timeline for proxy access as it relates to the company's calendar for the annual meeting and mailing of its proxy statement.
  - The board and the nominating and governance committee should 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. Note that, in past election contests, proxy advisors have very often been supportive of "short-slates" of directors nominated by activists, where they do not represent a majority of the board.
  - Review majority voting provisions to make sure that the customary exception for election contests is broad enough to encompass access nominations.
  - Companies should re-examine their shareholder relations and communications processes and consider strategies for constructive engagement. (See Appendix C).
  - Advance notice bylaws should be reconsidered in light of access requirements, recognizing

final analysis awaits further interpretation of the access rule's effect on advance notice bylaws. The interpretive issue arises because the access rule sets the requirements and procedures for a "nominee" to access a company's proxy statement. Companies are traditionally able under state law to establish in their bylaws reasonable regulation of the nomination process. Thus, to the extent advance notice bylaws establish conditions that must be met in order for a person to qualify as a nominee, such conditions may not necessarily be superseded by the access rule. As an interim approach, consider amending the advance notice bylaw to provide that any provision of the bylaw inconsistent with the access rule will be inapplicable to an access nomination to the extent the access rule supersedes the bylaw provision.

- Note that, notwithstanding the resolution of the pre-emption issue, advance notice bylaws will continue to be important in their application to nominations for which access is not sought in accordance with the rule, which may include nominations for which access is sought in accordance with a separate access regime established by a bylaw amendment sponsored by a shareholder under the new provisions of Rule 14a-8.
- Consider whether the informational requirements of the advance notice bylaw cover all of the items required to be furnished by a nominee under the access rule. It may be desirable to amend the bylaw to require any such items to be provided by all shareholder nominees, not just access nominees. By the same token, attention should be given to any informational requirements of the advance notice bylaw that an access nominee is not required to satisfy under the access rule, so the company can consider the significance of this to the proxy solicitation and the nominating committee can be prepared to take this informational deficit into account in considering an access nominee.
- Qualification requirements should also be considered. Qualification requirements are distinct from advance notice or other nomination requirements as they govern minimum requirements for being seated as a director. It appears that the access rule does not pre-empt qualification requirements that are valid under state law – opening up the possibility that an access nominee would be required to be presented in a company's proxy statement and could receive enough votes to be elected but would not be eligible to be seated as a director in light of a qualification requirements.[10] Companies should consider, first, whether there are in practice objective, minimum requirements for board membership that have not been included in the bylaws (for example, requirements stated in the company's board governance guidelines) that the board believes should be continued and formalized in the bylaws as qualification requirements. Second, consideration should be given to whether any new qualification requirements should be established in light of the fact that access nominees could be seated without being vetted by the nominating and governance committee of the board. Depending on the applicable corporate law, qualification requirements may be enforceable only if included in the charter or bylaws.

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 or against vote campaign on their re-election. When adopted (probably not until after the traditional 2011 season), the executive compensation and compensation committee independence disclosures required by the Act, 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 21, 2011.

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. The SEC has indicated that it plans to propose rules regarding these matters during October - December 2010 and to adopt them during January - March 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.[11] 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. SEC staff members have stated publicly that they believe the frequency vote is non-binding. 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. Alternatively, the frequency vote might be implemented through a single, multiple choice, plurality vote (annual, biennial, triennial or

abstain). This would require system reprogramming by Broadridge and transfer agents. It may also require amendments to a company's governing documents (e.g., an amendment to its bylaws to provide for plurality voting on the matter).

- *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 -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.

(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 21, 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. The SEC has indicated that it plans to propose rules regarding this disclosure (presumably, where, when and how it should be made) during October - December 2010 and to adopt them during January - March 2011.

- **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 some other institutional investors who are concerned about the demands the new vote will place on them (i) to analyze CD&As for all the companies in their portfolios or (ii) to "engage" with shareholders.
  - 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 ISS' voting guidelines – for if they do not, a company risks a substantial stockholder vote against on "say-on-pay." If ISS' 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. Traditionally, when permitted to do so without instructions, brokers have voted customer shares in a management-friendly way.

On September 9, 2010, the SEC approved an amendment to NYSE Rule 452 prohibiting any member broker from voting on an executive compensation matter without customer instructions, effective

immediately.[12] On September 24, 2010 the SEC approved on an accelerated basis an amendment to Nasdaq Rule 2251 prohibiting members from voting on director elections (other than uncontested elections at registered investment companies), executive compensation matters, and any other significant matter, as determined by the SEC, without voting instructions.[13] This prohibition on broker discretionary voting extends not only to the "say-on-pay" and other executive compensation votes added by Section 951 of the Act, but also to any kind of executive compensation matter that is the subject of a shareholder vote, including approval of a solely cash-based compensation plan. It will affect all member brokers voting shares of companies listed on the NYSE, Nasdaq or other national securities exchange, or not listed at all. Absent a contractual arrangement to the contrary, bank custodians are likely to follow the same voting practices.

The SEC has indicated that it plans to propose rules defining other "significant matters" for which broker discretionary voting will also be barred under exchange listing standards during April - July 2011 (with no indicated timeframe for adoption, but presumably at least in time for the 2012 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.[14]

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. Congressman Barney Frank, Chairman of the Committee on Financial Services, has publicly expressed a willingness to make technical corrections to clarify the requirements of the disclosure, including potentially excluding non-U.S. employees from the median calculation.

The Dodd-Frank Act does not include a deadline for rulemaking with respect to these new disclosures. However, the SEC has indicated that it plans to propose related rules during April - July 2011 (with no indicated timeframe for adoption, but presumably at least in time for the 2012 season) This timing gives companies 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. 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 has indicated that the related listing standards are planned to be proposed during October - December 2010 with adoption planned for April - July 2011.

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.[15] 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).[16]

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.

- **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.

- **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 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. The SEC has indicated that it plans to propose rules during April - July 2011 (with no timeframe for adoption indicated but presumably at least in time for the 2012 season).

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 (by lawsuit) 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 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 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[17] 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 SEC has indicated

that it plans to propose rules during April - July 2011 (with no timeframe for adoption indicated but presumably at least in time for the 2012 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.[18] 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. The SEC is required to issue final rules implementing these provisions not later than April 17, 2011. It has indicated that it plans to propose these rules during October - December 2010 and to adopt them during January - March 2011.

(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.[19] 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.[20] 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.

- **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.
  - Consider how to encourage employees throughout the organization to report suspected violations using the company's internal procedures 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.[21] 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,"[22] jointly, to prescribe regulations or guidelines to require "covered financial institutions" with assets of $1 billion or more[23] 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.[24]

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.[25] 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.[26]

Another helpful source of guidance for financial and non-financial companies alike was recently issued in final form by the Fed.[27] 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.[28] 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 threshold 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.[29] 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.[30] 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.

The SEC staff has been looking to modernize beneficial ownership reporting requirements for some time. However, it is uncertain when the SEC will propose changes to Regulation 13D-G.

- **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.[31]

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).[32] 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.[33] 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."[34]

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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Appendix A

SEC Rulemaking Update

I. New SEC Rules on Proxy Access

On August 25, 2010, the U.S. Securities and Exchange Commission exercised the discretionary authority granted to it by Section 971 of the Dodd-Frank Act, approving measures that substantially change the nomination and election process for directors of public companies. Under new Exchange Act Rule 14a-11, a company will be required to include on the company's proxy card – at its own expense – director nominees selected by a shareholder or a group of shareholders that meet certain eligibility requirements and to include information about such nominees in the company's proxy statement.

The principal eligibility standards for shareholder access to the company proxy are continuous ownership, for at least 3 years, of at least 3% of the total voting power of a company's securities entitled to vote in the election of directors. Access will be available for nominees for 25% of the board positions.

The SEC also adopted related amendments to the proxy rules to facilitate the formation of nominating groups and solicitations by nominating shareholders for their candidates, as well as an amendment to the beneficial ownership reporting rules (under Regulation 13D-G) to permit otherwise qualifying institutional and other nominating shareholders to continue to file short-form reports (Schedule 13G).

In addition, the SEC approved an amendment to Rule 14a-8(i)(8) requiring a company to include in its proxy materials proposals to establish procedures for the inclusion in the company's proxy materials of director nominees of a shareholder or group of shareholders (unless such proposal seeks to limit the availability of Rule 14a-11).

The new rules – other than the amendment to Rule 14a-8 – have come under court challenge, as the Chamber of Commerce of the U.S. and The Business Roundtable have sought to have the rules declared invalid as violative of the Administrative Procedure Act and on other grounds. A stay of effectiveness is being sought.

A copy of the adopting release is available at http://www.sec.gov/rules/final/2010/33-9136.pdf. The adopting release contains hundreds of pages of technical instructions and commentary about the new rules. This summary is intended, among other things, to explain in shorter form the key aspects of the new rules and the SEC's commentary.

Timing

The new rules are effective on November 15, 2010 (which is 60 days after their publication in the Federal Register). Under the rules, a nominating shareholder is required to give advance notice to the company and the SEC of its intent to access the company's proxy statement, in most circumstances not earlier than 150 days and not later than 120 days before the anniversary date of the mailing of the company's proxy materials for the prior year's annual meeting. Consequently, access nominations under the new rules will be permissible for the 2011 proxy season for companies that mailed their 2010 proxy statements on or after March 13, 2010, except for small reporting companies – generally, those with market capitalization of less than $75 million – for which the effectiveness of Rule 14a-11 is deferred for three years. Like Rule 14a-8, Rule 14a-11's submission deadlines trump any advance notice bylaw with

respect to access to a company's proxy materials; whether it pre-empts nomination requirements is unclear.

Things to Consider Now

Governance Structure The new rules create a "one size fits all" access regime. Companies should consider how their individual governance structures and processes, capitalization and other arrangements may be affected by the new access requirements and whether any adjustments are necessary. In particular, advance notice bylaws warrant a re-examination, to see how they will interact with the new rule's requirements.

Nominating Committee Processes Nominating committees, in particular, should be briefed on the key aspects of the new requirements and consider how they would react to an access nomination. Before finalizing their nomination decisions, nominating committees may wish to see if there will be any access nominees, which may affect the slate the committee will endorse. Procedures for vetting shareholder nominees should be considered, as well as for determining whether and how to negotiate with a nominating shareholder in an effort to avoid a contested election.

Annual Meeting Timeline The preparation schedule for annual meetings may also require modification to account for a potential election contest. If there is an access nomination, issues may arise as to the eligibility of the nominating shareholder and the company may need to go through the process established by the SEC for disputed nominations. In these circumstances, the company should become prepared for a contested election, ready to draw in its solicitation activities on the assistance of a proxy solicitation advisor. In addition, companies will need to revise their proxy statements to include applicable dates for the submission of director nominations by a shareholder or group of shareholders for the 2012 proxy season as required by revised Rule 14a-4.

Shareholder Relations Most importantly, companies should use the advent of access as a reason to re-examine their shareholder relations processes. Proxy access heightens the importance to companies of understanding shareholder concerns and maintaining good shareholder communications, particularly with their largest shareholders. Constructive engagement, not only on traditional matters such as financial performance and corporate strategy, but also on executive compensation and governance practices, may head off access efforts and build support for the board's nominees. Shareholder relations efforts undertaken before the access deadline may be especially important.

Although it seems likely that the volume of access activity in the upcoming proxy season will be limited pending the development of experience with the access process, it is nevertheless the prudent course for companies and particularly their boards to take steps to prepare themselves for the possibility of an access initiative.

Background

Whether and under what circumstances shareholders should be able to use company proxy materials to solicit votes for shareholder nominees has been a matter of significant debate.[35] Historically, shareholders have been able to recommend director candidates for nomination by a company's board, nominate candidates and solicit votes in support of their nominees. In order to solicit other shareholders on a widespread basis for support for its nominee, however, a shareholder was required to prepare and disseminate to shareholders a proxy statement and proxy card at its own expense. The SEC's creation of

a new right of access permits a shareholder to sponsor candidates at the company's expense and without making this effort.

The Commission voted 3 to 2 to adopt the new rules, with Commissioners expressing strongly divergent views. In most respects the new rules were adopted as proposed by the SEC in May 2009.[36]

Summary of the New Proxy Rules

Applicability

The new rules apply to all companies subject to the SEC's proxy rules (including investment companies), other than companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Securities Exchange Act of 1934, as amended.[37] A company is required to provide access under the new rules despite any contrary state law or charter or bylaw provision that limits shareholder access to company proxy materials.[38] Companies are not permitted to opt-out of the access rules' applicability. The access requirements are applicable even if the company is also subject to a traditional proxy contest.

Eligibility to Nominate

New Rule 14a-11 provides a process for an eligible shareholder (or group of eligible shareholders) to nominate through the company's proxy materials one or more directors for up to 25% of the company's board seats (or a minimum of one director). A nominating shareholder or group will be required to provide the company and the SEC notice on a new Schedule 14N of the intent to require the company to include its nominees in the company's proxy materials (generally no earlier than 150 days or later than 120 days before the anniversary of the mailing of the proxy materials for the last year's annual meeting).

To be eligible for proxy access, a nominating shareholder, individually or together with other shareholders making a nomination as a group, must:

- Beneficially own (as of the date it filed its Schedule 14N) at least 3% of the total voting power of the company's securities that are entitled to vote on the election of directors at the annual meeting (the "voting securities").
- Have beneficially owned the voting securities for at least 3 years (as of the date of the Schedule 14N) and must continue to hold such amount through the date of the election.
  - The rule as adopted represents a material change in the eligibility standards from the SEC's original June 2009 proposal, which were tiered according to company size as follows: 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 non-accelerated filers.
- Provide proof of ownership of the voting securities used for the purposes of satisfying the minimum ownership requirements.
- State in its Schedule 14N that it intends to continue to hold securities satisfying the minimum ownership requirement through the date of the annual meeting.
- State in its Schedule 14N its intent with respect to continued ownership of the company's securities after the election.

The nominating shareholder loses its eligibility if it participates in a nomination outside of Rule 14a-11 or in more than one nominating group. In addition, the nominating shareholder (including each member of a group) may not be holding any of the company's securities with the purpose, or with the effect, of changing control of the company or gaining seats on the board in excess of the maximum number of nominees permitted under Rule 14a-11 (and must so certify in its Schedule 14N).[39]

Determining Ownership Threshold

Rule 14a-11 includes instructions for calculating ownership in order to meet the 3% voting power threshold, including the following:

- The nominating shareholder must hold a class of securities subject to the proxy rules (thereby excluding holders of privately held classes of voting securities from access rights).
- The nominating shareholder must hold *both* voting *and* investment power (thereby excluding securities underlying options that are exercisable but have not been exercised).
- Shareholders are permitted to aggregate holdings in order to meet the 3% threshold.
- Shareholders are permitted to include securities loaned to a third party but only if they can be recalled and will in fact be recalled if the nominee is included in the company proxy statement.
- All short positions are netted out and borrowed shares are excluded.

In determining the total voting power of the company's securities, nominating shareholders are entitled to rely on information provided in the company's most recent annual, quarterly or current report, unless the shareholders know or have reason to know that this information is inaccurate.

Shareholder Nominee Requirements

A company is not required to include a shareholder nominee in its proxy materials if the nominee's candidacy or, if elected, his or her board membership would violate state or federal law or stock exchange rules (other than the rules regarding director independence). The nominee(s) must also satisfy the *objective* director independence standards set forth in the national securities exchange listing standards that apply to the company, if any (as opposed to those standards requiring a subjective board determination of independence). There is no requirement that the director be independent from or unaffiliated with the shareholder making the nomination. Each nominating shareholder will be required to represent that neither the nominee nor the nominating shareholder has a direct or indirect agreement with the company regarding the nomination of the nominee prior to filing the Schedule 14N.

Maximum Number of Shareholder Nominees

A company is required to include no more than the greater of one shareholder nominee or the number of nominees that represent no more than 25% of the company's board (or the closest whole number below 25% where 25% does not result in a whole number). Where a company has a staggered board, the 25% calculation is based on the total number of board seats and not the number of board seats being voted on at the upcoming meeting. Where a nominating shareholder owns shares of a class that has the right to elect a subset of the full board, the maximum number of nominees of such a shareholder that a company is required to include may not exceed the number of director seats that the class of shares is entitled to elect.

Incumbent directors that were elected as a result of shareholder nomination pursuant to Rule 14a-11 and have a term on a classified board that will continue after the election to which proxy materials relate count toward the maximum permitted number of shareholder nominees in future elections. However, where the company decides to nominate a director that was previously nominated by a shareholder through proxy access for an earlier election, such director will not count toward the maximum.

To encourage dialogue between companies and nominating shareholders, Rule 14a-11 provides that if, in negotiations that are initiated after a shareholder files a Schedule 14N, the company agrees to include one or more of the shareholder's nominees as company nominees, those nominees count toward the 25% maximum. This allows a company's board to negotiate with a nominating shareholder and reach a consensus on the board's nominees without thereby creating a position for another shareholder nominee (but only *after* the nominating shareholder has filed a Schedule 14N). Thus, a negotiated arrangement with a shareholder regarding board composition will not affect the availability of access unless it occurs after the shareholder has "gone public" in a Schedule 14N.

Multiple Nominations

In cases where the company receives more access nominations than it is required to include in its proxy statement and in cases of withdrawn or disqualified nominations, the shareholder or group with the highest qualifying voting power percentage – not the "first-in time" shareholder or group as the SEC originally proposed – has priority. Thus, in the event that the company receives more shareholder nominees than it is required to include in its proxy materials, the company is only required to include in its proxy materials the nominees of the shareholder or group which has the highest qualifying voting power percentage disclosed in the Schedule 14Ns.

Notice and Disclosure Requirements

The Schedule 14N must be submitted to the company on the same day that it is filed with the Commission, which must be no earlier than 150 calendar days nor later than 120 calendar days before the anniversary date of the company's mailing of its proxy materials for the prior year's meeting. Companies will need to revise their proxy statements to include applicable dates for the submission of director nominations by a shareholder or group of shareholders for the 2012 proxy season as required by revised Rule 14a-4. If, however, the date of the meeting has changed by more than 30 calendar days from the prior year (or if the company is holding a special meeting or conducting an election by written consent), then the notice must be transmitted a "reasonable time" before the company mails its proxy materials. This date must be specified and disclosed in a Form 8-K filed pursuant to a new Item 5.08 within four business days after the company determines the date of the meeting.[40] The access timing requirement may differ from the date provided for in the company's advance notice bylaw.

A nominating shareholder must provide the company with a notice, on Schedule 14N, of the intent to require the company to include its nominees in the company's proxy materials.[41] Schedule 14N may include a statement of support for the nominee, and the company is required to include this statement with its proxy materials so long as it is no more than 500 words in length.[42] The Schedule 14N must include the same information regarding the nominee and nominating shareholder (and all members of a nominating shareholder group) required to be provided in a traditional proxy contest plus certain additional information and representations relating to Rule 14a-11's eligibility requirements and certifications regarding the shareholder's (or group's) ownership and intentions.

Procedures Upon Receipt of Notice

Upon receipt of Schedule 14N from a shareholder or group, the company must determine whether any of the circumstances permitting exclusion of its nominees apply.

- If the company determine not to challenge eligibility and thus include a shareholder's (or group's) nominee(s), it must notify the nominating shareholder (or group) not later than 30 calendar days before it files its definitive proxy statement and form of proxy with the Commission. The company must then include in the company's proxy statement the required disclosure regarding the shareholder nominee(s), the nominating shareholder (or group) and the statement of support. The company must also include the name of the shareholder nominees on the company's form of proxy.[43]
- If the company decides to challenge eligibility, the company must advise the SEC no later than 80 days before the company wishes to file its definitive proxy statement. The company bears the burden of demonstrating that it may exclude a nominee submitted under Rule 14a-11.

The new rule establishes a procedure, modeled after the SEC staff no-action process applicable to shareholder proposals under Rule 14a-8, that must be followed when a company seeks to exclude from its proxy materials a shareholder nomination received pursuant to Rule 14a-11. The following chart, included in the adopting release, summarizes the procedure:

Due Date	**Action Required**
No earlier than 150 calendar days and no later than 120 calendar days before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting	Nominating shareholder or group must provide notice on Schedule 14N to the company and file the Schedule 14N with the Commission
No later than 14 calendar days after the close of the window period for submission of nominations	Company must notify the nominating shareholder or group (or its authorized representative) of any determination not to include the nominee or nominees
No later than 14 calendar days after the nominating shareholder's or group's receipt of the company's deficiency notice	Nominating shareholder or group must respond to the company's deficiency notice and, where applicable, cure any defects in the nomination
No later than 80 calendar days before the company files its definitive proxy statement and form of proxy with the Commission	Company must provide notice of its intent to exclude the nominating shareholder's or group's nominee or nominees and basis for its determination to the Commission and, if desired, seek a no-action letter from the staff with regard to its determination
No later than 14 calendar days after the nominating shareholder's or group's receipt of the company's notice to the Commission	Nominating shareholder or group may submit a response to the company's notice to the Commission staff

As soon as practicable	If requested by the company, the Commission staff would, at its discretion, provide an informal statement of its views to the company and the nominating shareholder or group
Promptly following receipt of the staff's informal statement of its views	Company must provide notice to the nominating shareholder or group stating whether it will include or exclude the nominee

Amendments to Rule 14a-8(i)(8)

The amendment to Rule 14a-8(i)(8) substantially narrows the categories of shareholder proposals concerning director elections that a company may exclude from its proxy materials.[44] Previously, Rule 14a-8(i)(8) permitted companies to exclude shareholder proposals that "relate to an election." Rule 14a-8(i)(8) as amended, eliminates this broad exclusion. A company, generally speaking, will now be required to include in its proxy materials shareholder proposals concerning nomination procedures or disclosures to be made regarding shareholder nominations, including access proposals, as long as the proposed action would not conflict with Rule 14a-11 and is otherwise not excludable under Rule 14a-8 (e.g., because it is in violation of state law).[45] The normal qualification requirements to make such a proposal under Ru1e 14a-8 apply. Under the amended rule, a shareholder could propose provisions with more liberal access requirements (*e.g.*, 2% ownership) but not more stringent requirements (*e.g.*, 5% ownership).

The amendments to Rule 14a-8 are intended to facilitate the presentation of proposals by shareholders to adopt company-specific procedures for including shareholder nominees for director in company proxy materials.

Other Rule Amendments

The Commission also adopted rule amendments intended to facilitate the formation of a group of shareholders having collectively the ownership level required for eligibility to make an access nomination and the conduct of a solicitation by a nominating shareholder in support of its candidates, and to clarify the beneficial ownership reporting obligations of a nominating shareholder.

New Solicitation Exemptions

Under new Rule 14a-2(b)(7), a proxy statement need not be furnished to a person solicited (and related requirements need not be complied with) where the solicitation is made in connection with forming a shareholder group to seek access under Rule 14a-11 for a director candidate.[46] Under new Rule 14a-2(b)(8), a solicitation by the nominating shareholder in support of a nominee for whom access was provided, or urging a vote against a nominee of the company, outside the proxy statement (for example, on a designated website) is exempted from the proxy statement delivery (and related) requirements, provided that the soliciting party does not seek the power to act as a proxy for a shareholder and does not furnish or request any form of proxy, revocation, abstention, consent or authorization.[47]

These exemptions (and Rule 14a-11) are not be available to a person who subsequently engages in other solicitation or nomination activities in connection with the same election of directors or who becomes a member of a group (as determined for beneficial ownership reporting purposes under Section 13(d)) with

any person (other than another member of the nominating group) engaged in soliciting or nominating activities for the same election.

Beneficial Ownership Reporting Requirements

Under the new rules, a nominating shareholder or group will not lose eligibility to file abbreviated beneficial ownership reports as a passive investor pursuant to Schedule 13G solely as a result of making a nomination pursuant to Rule 14a-11, soliciting in connection with such nomination (including soliciting in opposition to a company's nominees) or having a nominee elected to the board.[48] Further disclosures will be required in the group's Schedule 14N. This Schedule 13G eligibility provision will not be available to the group after the election of directors.

Beneficial ownership reporting requirements under Section 16 of the Securities Exchange Act are unaltered.[49] Accordingly, shareholders who come together as a nominating group must determine whether their collective ownership of shares exceeds the 10% level at which a report is required under the existing Section 16 rule provisions, which also triggers concomitant trading restrictions. Whether this reporting requirement will apply will depend on the nature of the group members and the capacity in which they hold shares.[50] A shareholder must continue to consider the possibility that having a nominee successfully elected to the company's board pursuant to Rule 14a-11 may result in the nominating person being deemed a director subject to Section 16.

Application of Liability Provisions

An amendment to Rule 14a-9 confirms that it is unlawful for a nominating shareholder to cause any false or misleading statement to be included in the company's proxy materials, subjecting the nominating shareholder to enforcement penalties under the Securities Exchange Act and, under applicable case law, an implied private right of action to remedy such a violation. However, consistent with the existing approach in Rule 14a-8, under Rule 14a-11(f), a company will not be responsible for the accuracy or completeness of any information provided by a nominating shareholder, despite the inclusion of the information in its proxy materials.

New Item 5.08 of Form 8-K

A new Item 5.08 of Form 8-K requires the company to disclose the date (which must be a reasonable time before the company mails its proxy materials) by which a nominating shareholder must submit the Schedule 14N if the company did not hold an annual meeting the previous year, or if the date of this year's annual meeting has been changed by more than 30 days from the date of the previous year's meeting. The Item 5.08 Form 8-K must be filed within four business days after the company determines the date of the meeting.

New Rule 14a-18

A new Rule 14a-18 has also been adopted and will apply to shareholder nominations for inclusion in the company's proxy materials made pursuant to procedures established by state law or by a company's governing documents. The rule requires a nominating shareholder or group utilizing such provisions to file a Schedule 14N and include in it certain disclosures concerning the nominating shareholder or group and the nominee, which are similar to what would be required under the proxy rules in an election contest.

II. New SEC Rule Further Limiting Broker Discretionary Voting

On September 9, 2010, the SEC approved an amendment to NYSE Rule 452 that prohibits any member broker from voting on an executive compensation matter without customer instructions. On September 24, 2010 the SEC approved an amendment to Nasdaq Rule 2251 that prohibits any member from voting on director elections (other than uncontested elections at registered investment companies), executive compensation matters, and any other significant matter, as determined by the SEC, without voting instructions. These amendments implement Section 957 of the Act and took immediate effect.

The new prohibition on broker discretionary voting extends not only to the "say-on-pay" and other executive compensation votes added by Section 951 of the Dodd-Frank Act, but also to any kind of executive compensation matter that is the subject of a shareholder vote. It affects all member brokers voting shares of companies listed on the NYSE, Nasdaq or other national securities exchange, or not listed at all. The same voting practices are likely to be followed by bank custodians, consistent with current practices.

The amendment to NYSE Rule 452 and related changes to the NYSE Listed Company Manual Section 402.08 added any matter that "relates to executive compensation" to the list of matters on which member brokers may not give or authorize a proxy to vote customer shares without instructions from beneficial owners. According to the commentary, a matter "relating to executive compensation" includes – but is not limited to – the three advisory votes required by Section 951 of the Dodd-Frank Act (i.e., "say-on-pay," "say-when-on-pay," and advisory votes on "golden parachutes").

Under Rule 452 as amended, the matters on which broker discretionary voting can no longer be exercised include, for example, cash-based incentive plans for executive officers (irrespective of the impact on average annual income), executive officer performance measures and other executive compensation matters that may be presented to shareholders in accordance with stock exchange rules and/or Section 162(m) of the Internal Revenue Code.[51]

Appendix B

More to Come and When to Expect it: Further Required SEC Implementing Action

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
Part I. 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 adopted rules providing access on August 25, 2010.	The rules become effective on November 15, 2010, and will apply to the 2011 proxy season for companies that mailed their 2010 proxy statements on or after March 13, 2010.	All public companies, except for smaller reporting companies.
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. Proposed rules planned to be issued October – December, 2010 and adopted January – March, 2011.	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 21, 2011 (six months after enactment). Resolutions relating to golden parachute provisions are required to be voted on at meetings held on or after January 21, 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. Proposed rules planned to be issued. October – December, 2010 and adopted January – March, 2011.		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. Proposed rules on defining "other	On September 9, 2010, the SEC approved an amendment to NYSE Rule 452 prohibiting discretionary voting	Member brokers of national securities exchanges; with respect to shares of all companies, whether or not listed.

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
	significant matters" planned to be issued April – July 2011.	by brokers on compensation matters. On September 24, 2010, the SEC approved an amendment to Nasdaq Rule 2251 prohibiting discretionary voting by brokers on director elections, executive compensation and any other "significant matters"	
Part II. 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. Proposed rules planned to be issued April – July 2011.		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. Proposed rules planned to be issued April – July 2011.		All public companies.
Part III. 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). Proposed exchange listing standards and rules planned to be issued October – December 2010 and adopted April – July 2011.	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	SEC rulemaking required and national securities exchanges to issue related listing rules. Effective national securities exchange rulemaking in accordance with SEC		All listed companies, other than controlled companies. National securities exchanges may exempt a category of issuers, taking into account the potential

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
(§952)	rules required by July 16, 2011 (360 days after enactment). Proposed exchange listing standards and rules compensation consultant conflicts planned for October – December, 2010 and to be adopted April – July 2011.		impact on smaller issuers.
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. Proposed rules planned to be issues October – December 2010 and adopted for April – July 2011.	Proposed rules planned to be issued October – December 2010 and adopted April – July 2011. 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 IV. 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. Proposed rules planned to be issued April – July 2011.		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. Proposed rules planned to be issued April – July 2011.		All public companies.

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
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. Proposed rules to implement a whistleblower incentives and protection program planned to be issued October – December 2011 and adopted January – March 2011. 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 protections effective upon enactment.	All public companies.
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. Proposed rules on §763 regarding swaps planned to be issued October – December 2010 and adopted April – July 2011.	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	“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

Provision	*Further Regulatory Action?*	*Effective Date*	*Applicability*
		accordance with Fed regulations.	necessary or appropriate by the Fed to promote sound risk management.
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. Proposed rules planned to be issued October – December 2010 and adopted April – July 2011.	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 V. 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 VI. 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 C

Assessing Shareholder Relations: Questions to Ask

A board should consider the following questions when assessing the company's approach to shareholder relations:[52]

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] 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.

[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 ISS' Governance Analytics service. Of the majority voting proposals, 19 received a majority of votes in favor. Of the declassification proposals, 29 received a majority of votes in favor. Of the special meeting proposals, 12 received a majority of votes in favor.

[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. Of the majority voting proposals, 19 received a majority of 19 votes in favor or the declassification proposals, 29 received a majority of votes in favor of the special meeting proposals, 12 received a majority of votes in favor

[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] It does not appear from the text of the access rule and the proposing release that the access rule supersedes director qualification provisions that a corporation may establish in its bylaws (or otherwise as permitted by corporate law). Under Rule 14a-11(b)(8), a condition of eligibility for access under the rule is that the "nominee's candidacy or, if elected, board membership would not violate controlling Federal law, State law, foreign law, or rules of a national securities exchange…." Valid director eligibility requirements would be permitted and enforceable under state law, so this provision seems to comprehend such provisions. In addition, Schedule 14N (Item 5E) requires a shareholder sponsoring an access nominee to disclose whether, to the best of its knowledge, the nominee meets the director qualification requirements set forth in the company's governing documents. This implies that the access rule does not supersede director qualification requirements.

[11] 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."

[12] SEC Release No. 34-62874; File No. SR-NYSE-2010-59 (September 9, 2010)

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[13] SEC Release No. 34-62992; File No. SR-NASDAQ-2010-114 (September 24, 2010)
[14] Webcast, "Inside Track with Broc: Peggy Foran and Ed Ballo on Results of Innovative Voting Campaign," *The Corporate Counsel* (June 1, 2010).
[15] *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).
[16] *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).
[17] The SEC did not provide guidance on Section 304 of the Sarbanes-Oxley Act.
[18] *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.
[19] 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.
[20] 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.
[21] "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).
[22] "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.
[23] "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.
[24] 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.

[25] *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.

[26] 31 C.F.R. §§30.3 & 30.5.

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

[28] 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).

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

[30] 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.

[31] 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").

[32] *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.).

[33] Exchange Act Rule 13d-3.

[34] Concept Release at 145, n328.

[35] The SEC's current action, based on its May 2009 proposal, represents the third time in recent years that the Commission has taken up proxy access. In 2003, the SEC proposed a rule providing shareholder access to company proxy material under certain limited conditions. See Release No. 34-48626, Security Holder Director Nominations (October 14, 2003). After receiving extensive comment on the proposal, the Commission declined to adopt the proposed rule. In 2007, the SEC proposed amending Rule 14a-8 to permit shareholder proposals establishing a right of access, but eventually decided not to do so and instead clarified that under the rule such proposals were not permitted. See Release No. 34-56914, Shareholder Proposals Relating to Election of Directors (December 6, 2007).

[36] *See* SEC Proposing Release, *Facilitating Shareholder Director Nominations* (Release No. 33-9046, 74. Fed. Reg. 29024) (June 18, 2009), available at www.sec.gov/rules/proposed/2009/33-9046.pdf.

[37] The rules do not apply to foreign private issuers, as Securities Exchange Act Rule 3a12-3 exempts foreign private issuers from the Commission's proxy rules.

[38] As a formal matter, an exception is provided where applicable state or foreign law or a company's governing documents prohibit shareholders from nominating candidates for the board. No such provisions are known to exist, at least among domestic companies.

[39] The Commission has acknowledged the possibility that, after a company has distributed proxy materials that include information about the nominee of a shareholder, the nominating shareholder's intent may change to include a change in control of the company. The rules require the nominating shareholder to disclose this change in its intent in an amendment to Schedule 14N. The adopting release also clarifies that the Commission could take enforcement action with respect to a shareholder that provides false certifications in connection with its Schedule 14N and that such person could be liable under Rule 14a-9 for materially false or misleading certifications.

[40] This is similar to the requirement currently in Rule 14a-5(f), which specifies that, where the date of the next annual meeting is advanced or delayed by more than 30 calendar days from the date of the annual meeting to which the proxy statement relates, the company must disclose the new meeting date in the company's earliest possible quarterly report on Form 10-Q.

[41] The nominating shareholder or group will be required to file promptly an amendment to Schedule 14N for any material change in the facts set forth in the original Schedule 14N. The nominating shareholder or group will also be required to file a final amendment to the Schedule 14N disclosing within 10 days of the final election results the nominating shareholder's or group's intention with regard to continued ownership of their shares. The adopting release expresses that requiring such amendment will provide shareholders with information as to whether the outcome of the election may have altered the intent of a nominating shareholder and what further plans the nominating shareholder may have with regard to the company.

[42] It should be noted that the shareholder or group could also post additional supporting statements on a designated website. Such website must be disclosed on Schedule 14N.

[43] The rules clarify that inclusion of a shareholder nominee in the company's proxy materials will not be deemed a "solicitation in opposition," requiring the company to file a preliminary proxy statement. Thus, the company can still file its proxy statement only in definitive form, provided that it is otherwise qualified to do so.

[44] The amendment to Rule 14a-8(i)(8) specifies the types of proposals that will be excludable under Rule 14a-8(i)(8), largely codifying prior staff interpretations of the director election exclusion. A company would be permitted to exclude a proposal under Rule 14a-8(i)(8) only if it: (1) would disqualify a nominee who is standing for election; (2) would remove a director from office before his or her term expired; (3) questions the competence, business judgment, or character of one or more nominees or directors; (4) nominates a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision, or a company's governing documents; or (5) otherwise could affect the outcome of the upcoming election of directors. With the broader "otherwise could affect the outcome of the upcoming election" language, the Commission is seeking to address new proposals that may be developed over time that are comparable to the four specified categories and would undermine the purpose of the exclusion.

[45] The amendment of Rule 14a-8 takes into account recent corporate law developments confirming the validity of bylaws providing a right of access to corporate proxy materials. On April 10, 2009, the Governor of Delaware signed into law new legislation permitting, but not requiring, Delaware companies to adopt bylaws that would provide for shareholder access to company proxy materials for the purpose of proposing director nominees pursuant to the procedures and conditions set forth in such bylaws (Section 112 of the Delaware General Corporation Law), and for the reimbursement of expenses incurred by the nominating shareholder in soliciting proxies (Section 113). Such bylaws can be adopted either by the company's board of directors or nominating shareholders. Bylaws adopted under new Section 112 (which became effective August 1, 2009) may include procedures and conditions under which a company soliciting proxies for the election of director nominees would also be required to include in its proxy materials nominees submitted by shareholders. For a detailed discussion of these amendments, *see* http://www.weil.com/news/pubdetail.aspx?pub=9434.

[46] In order to qualify for the exemption, any written communications used must be limited to a statement of intent to form a group to seek access, a brief statement regarding the potential candidate (or, if none has been identified, the characteristics of a candidate), the percentage of securities beneficially owned by the soliciting shareholder and the means by which shareholders may contact the soliciting shareholder. A copy of this material must be filed with the Commission.
[47] Any written communication used as part of such solicitation must identify each nominating shareholder and describe its direct or indirect interests in the matter, by security holdings or otherwise, and contain a prominent legend that refers shareholders to the company's proxy statement for important information. Any such materials must be filed with the Commission when first given to any shareholder.
[48] Shareholders who come together as a nominating group and as such a group collectively have, but otherwise would not have had, beneficial ownership of 5% or more of a company's shares may as a result be required to file a beneficial ownership report, applying traditional "acting in concert" standards for determining if the shareholders constitute a "group" for beneficial ownership reporting purposes. Under the new rules, such a group will be eligible to report using the abbreviated Schedule 13G, assuming they otherwise satisfy the requirements for use of Schedule 13G.
[49] Under Rule 16a-1(a)(1), shares held by certain regulated entities for third-party accounts are not considered beneficially owned for purposes of determining if the 10% beneficial ownership threshold is satisfied (even though the shares are considered beneficially owned for Section 13(d) reporting purposes).
[50] The adopting release indicates that an exception for nominating group activity was not provided for Section 16 purposes as the proposed ownership thresholds for exercising access rights are substantially below 10% and the possible application of the Section 16 reporting requirement is not expected to discourage use of access.

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[51] Member brokers may not vote without customer instructions even if broker discretionary voting would otherwise be permitted pursuant to Item 12 (relating to equity compensation plans or material revisions of existing equity compensation plans), Item 13 (relating to certain new profit-sharing or special remuneration plans), or any other item under NYSE Rule 452.11 and NYSE Listed Company Manual Section 402.08.
[52] *See* Holly J. Gregory, "Financial Reforms: Influencing a 'New Normal' in Corporate Governance," *Practical Law The Journal* (June 2010).